S. HRG. 99-736

NOMINATIONS OF FRANK W. NAYLOR, JR., AND MARVIN R. DUNCAN

HEARING

BEFORE THE

COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

ON

THE NOMINATIONS OF FRANK NAYLOR, JR., OF VIRGINIA, AND MARVIN DUNCAN, OF MISSOURI, TO BE MEMBERS OF THE FARM CREDIT ADMINISTRATION BOARD

MAY 15, 1986

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NOMINATIONS OF FRANK W. NAYLOR, JR., AND MARVIN R. DUNCAN, TO BE MEMBERS OF THE FARM CREDIT ADMINISTRATION BOARD, FARM CREDIT ADMINISTRATION

THURSDAY, MAY 15, 1986

U.S. SENATE,
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,
Washington, DC.

The committee met, pursuant to notice, at 9:39 a.m., in room SR-332, Russell Senate Office Building, Hon. Jesse Helms (chairman of the committee) presiding.

Present: Senators Helms, Dole, Boschwitz, Andrews, Wilson, McConnell, Zorinsky, Leahy, Boren, and Harkin.

STATEMENT OF HON. JESSE HELMS, A U.S. SENATOR FROM NORTH CAROLINA

The CHAIRMAN. The committee will come to order.

Let the Chair state, that in addition to handling two nominations that need to be expedited as much as possible, as soon as we are through with the nomination hearing, we will move right into the Chernobyl hearing, and this Chernobyl hearing ought to be very interesting, and perhaps significant with respect to a lot of things that all of us are interested in.

First, we will go into the nominations of Hon. Frank W. Naylor, Jr., member-designate of the Farm Credit Administration Board, Farm Credit Administration, and, let me suggest, Frank, that you sit to the left of Bob Dole.

Mr. NAYLOR. That is fine. Thank you.

The CHAIRMAN. And Dr. Marvin R. Duncan, member-designate of the Farm Credit Administration Board, Farm Credit Administration, and you please sit to the left of Frank Naylor. I do not know what sort of pecking order this is.

Before we start, I would like to identify the members of the families of the two nominees who may be present.

Frank, would you do that, please, and I would like them to stand, since they are such good-looking ladies.

Mr. NAYLOR. Mr. Chairman, I am very pleased to have, in addition to my staff, my wife Karen, and my daughter Mary, with us today, and I am very pleased to have them here and have the opportunity to have them join us this morning.

The CHAIRMAN. We welcome them to the committee, and we will not be too hard on you. [Laughter.]

Mr. Duncan.

Dr. DUNCAN. I have no family with me today.

Senator DOLE. They cannot stand the sight of blood, right? [Laughter.]

The CHAIRMAN. All right. Very well. Both of these gentlemen are well known to members of this committee, and therefore need no introduction, but for the record, and purely for that, let me say that Frank Naylor has served admirably as Under Secretary of Small Community and Rural Development for the USDA since 1981, and in this capacity, he has been at the forefront of policy development in agricultural credit for the administration.

All of us have worked closely with him and we know the depth of his understanding about this most critical subject.

Marvin Duncan, meanwhile, has been Senior Deputy Governor for the Farm Credit Administration since this past August, and therefore actively involved in the development of the Farm Credit Act amendments of 1985.

Subsequent to assuming the position at FCA, Dr. Duncan had served as vice president and economist of the Federal Reserve Bank in Kansas City.

He has been deeply involved with agriculture all of his life and brings a personal perspective to this position, and I am pleased that the President has elected to nominate these two men.

Senator Dole, do you have a statement?

STATEMENT OF HON. BOB DOLE, A U.S. SENATOR FROM KANSAS

Senator DOLE. I will just say a word. I think Senator Wilson wanted to be here to introduce Frank Naylor, but I am very proud to do that. Frank is a native Kansan. He spent some time in California but he went to school in Kansas, attended the University of Kansas, and I think has made an outstanding record.

I have known Frank, known his parents, I know his family, and I know him to be a man of honesty and integrity, and I think that is what we are looking for. We really need help in this area. I would like to include my statement in the record in support of the Naylor nomination.[1]

I also want to indicate that I have known Mr. Duncan for a number of years. He has been very helpful as an objective adviser—not partisan in any sense—but whenever we needed some help or some figures, he has always been willing to be of assistance to both me and my staff over the years.

So, he has been a big asset. Now it is important that we get the new board in place. I do not know what the chairman's plans are, but I am hopeful that we can expedite these nominations. There are a lot of people that are sort of "at sea" out there, and there's a lot of drifting going on. I have to open up the Senate in a few minutes but I hope when questions are asked of the nominees, that Tom Harkin would inquire of the nominees whether the FCA would be supportive of this resolution that 60 of us have now cosponsored.

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[1] See p. 47 for the prepared statement of Senator Dole.

I think Mr. Naylor would be prepared to say that it would be helpful. I think that is the question that Senator Harkin would like to have answered.

If it is going to do some good, then I hope Senator Harkin would not object to it. If it was just another piece of paper floating through the Senate, then I think he has a valid reason to hold it up, if it is not going to do any good. Mr. Chairman, I do appreciate the chance to introduce my friend from Kansas, and also to say a word about Mr. Duncan.

The CHAIRMAN. Very well. Mr. Leader, we are delighted to have you here. We know you have other pressing obligations. Senator Zorinsky.

STATEMENT OF HON. EDWARD ZORINSKY, A U.S. SENATOR FROM NEBRASKA

Senator ZORINSKY. Mr. Chairman, I am pleased that we are finally considering nominations to two of the three positions on the Board of the Farm Credit Administration. It is certainly not this committee's fault that it has taken so long to get to this point. The delay is most regrettable. I firmly believe that the delay has only served to heighten the tension that exists throughout the Farm Credit System.

Congress established the Farm Credit Administration as an independent regulator. I would hope that both of the nominees, if confirmed as members of the Board, will act with the independence that would be entrusted to them.

Mr. Chairman, I ask that my prepared statement on the nominees be placed in the record.[1]

The CHAIRMAN. Of course. Without objection, so ordered. Senator Boschwitz.

Senator BOSCHWITZ. No opening statement.

The CHAIRMAN. Excuse me. I think Tom Harkin was here first. Do you have an opening statement?

Senator HARKIN. I do not have an opening statement.

The CHAIRMAN. Now, Senator Boschwitz.

Senator BOSCHWITZ. I have a statement for the record, Mr. Chairman.[2]

The CHAIRMAN. Senator Andrews.

STATEMENT OF HON. MARK ANDREWS, A U.S. SENATOR FROM NORTH DAKOTA

Senator ANDREWS. I do, briefly, Mr. Chairman, because one of the nominees, Marvin Duncan, is from North Dakota. Marvin just happens to have graduated with a degree in agronomy from a certain institution that I graduated from with a degree in agronomy, and that does not mean that he is going to follow the same pattern that I have, Mr. Chairman, so you can relax. [Laughter.]

Mr. Duncan returned, after he got his degree, to the family farm and livestock operation in Cavalier County. This area is part of the Durum Triangle in North Dakota. It is a great farm region.

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[1] See p. 48 for the prepared statement of Senator Zorinsky.
[2] See p. 49 for the prepared statement of Senator Boschwitz.

As a young man, he helped me in my first statewide campaign. I will not tell you the results of that first statewide campaign but if they had been different, I probably would not have been here today. I can say that it was one of those interesting campaigns and I appreciated his help.

He returned to NDSU in 1970 and earned a master's degree in economics in 1972. He then attended Iowa State and received his Ph.D. in 1974.

He joined the Federal Reserve Bank in Kansas City as an ag economist. Before joining FCA, Mr. Duncan served in different capacities with the Federal Reserve such as an economist and vice president, headed up the regional economics group within the economic research department. Currently, Mr. Chairman, he is with FCA as a Senior Deputy Governor. He has been responsible for directing strategic planning for the agency.

Not only is he a native North Dakotan, coming from a farm family, Mr. Chairman, but he also retains interest in the family farm back in North Dakota. Certainly he is sensitive to the farmers of this Nation.

He has a broad and a good solid background in agricultural economics, and banking, and wholeheartedly supports the need for the Farm Credit Administration system to move ahead with farm debt restructuring, and I am glad to recommend to you, Mr. Chairman, this North Dakota native.

The CHAIRMAN. Thank you very much.

Mr. Naylor, do you have an opening statement?

STATEMENT OF HON. FRANK W. NAYLOR, JR., MEMBER-DESIGNATE, FARM CREDIT ADMINISTRATION BOARD, FARM CREDIT ADMINISTRATION

Mr. NAYLOR. Thank you, Mr. Chairman. I want to thank the committee for the opportunity to appear before you today concerning this nomination.

I think it is perhaps appropriate, that this is the anniversary of the founding of the Department of Agriculture, and, if I recall correctly, it was also the same date 5 years ago when I appeared before this committee for the purpose of confirmation for the Under Secretary's position at the Department.

Mr. Chairman, last fall, the Congress of the United States under your able leadership, and the members of this committee worked very diligently to develop and pass an effective, and very much-needed piece of legislation to give us the necessary tools to assist a very troubled Farm Credit System.

We have had some delay in getting those new procedures into place, and I think it is critically important that we move forward as rapidly as possible to accomplish that. But I think most of all, there are principal concerns shared by all of us. Our principal objective is to ensure that what we do will produce a viable, competitive Farm Credit System that will continue to be the principal lender to American agriculture, and to do so in a way that will ensure its long-term strength and viability for American agriculture and its future.

I think we have the necessary tools within that legislation to do that. I think the Congress of the United States produced an unusual and very strong piece of legislation, which sets in motion what needs to be done to reestablish this system in its leadership role that it has held over the years.

I pledge myself to carry out fully the provisions of that law, and to ensure that we achieve that objective and we achieve it as promptly as possible. I appreciate the opportunity to be with you today and to answer the questions of the committee.

The CHAIRMAN. Thank you, sir.

[Questions submitted by Senator Helms to Secretary Naylor and answers thereto:]

Question. Would each of you please discuss your views on how the Capital Corporation should be utilized to assist in work-outs for troubled borrowers?

Answer. I anticipate that economy of operation will in almost all cases require that loans to troubled borrowers continue to be serviced at the local level by the originating institution. In those cases, the Capital Corporation can act in a consultative capacity to provide technical expertise to the lender and to assure a level of consistency in approach to such matters. Such expertise could include accounting, financial, or loan servicing advice designed to minimize the institution's risk of loss and to provide the best solution to the borrower whenever a workout is a viable alternative.

Question. We all recognize that the Farm Credit System is a cooperative—owed by its member/borrowers. Therefore, granting special concessions to some borrowers results in additional expense to others. In your opinion, to what extent can the System offer forbearance to troubled borrowers without causing excessive hardship to other borrowers who are also struggling to make payments?

Answer. In cooperative businesses, both the benefits and the costs of operations are shared by the owners. Therefore, loan losses and reductions in loan income due to the stressed condition of the borrowers, cause higher interest rates to be charged to the borrowers who are able to pay their loans. It is true that providing lending concessions, including forbearance, to troubled borrowers, may result in an unnecessary additional economic load being placed on the paying borrowers. Banks and associations of the Farm Credit System may offer forbearance to troubled borrowers without causing excessive hardship to other borrowers through the use of loan reamortization, restructuring, and rescheduling and other such loan adjustments that provide the best economic return to the institution.

Question. Do you believe there is an ongoing need for the Farm Credit System in its present configuration of district banks and local associations and do you believe it has a significant role to play in modern U.S. agriculture?

Answer. I do believe that there is a significant need for the credit servicing that is provided by the cooperative Farm Credit System, particularly long-term farm real estate financing. I endorse the continuation of a structure of district banks and local associations that provides for borrowers owning and directing their credit cooperatives.

Question. In your opinion what specifically would it take to convince you that the Farm Credit System has fully utilized its resources and is eligible to receive direct federal assistance?

Answer. The Farm Credit Act is clear on the conditions that must exist before the FCA can certify that the System is eligible to request direct Federal assistance. It must have fully committed its available capital surplus and reserves to addressing its financial difficulties and that further contributions or losses by System institutions would preclude them from making credit available to eligible borrowers on reasonable terms.

While the precise conditions that might exist are difficult to determine at this point, the System will have fully used its resources when the available capital and reserves of System institutions, as defined by Congress, have been fully committed to providing assistance to financially troubled institutions.

I am committed to taking any actions within my authority to maintain the continued viable operations of the Farm Credit System.

Question. There has been considerable discussion lately regarding the need for a new secondary market to assure the availability of mortgage financing for agriculture. What is your opinion of this idea and what impact would it have on the viability of the Farm Credit System if implemented in the near future?

Answer. There may be circumstances in which a private secondary market for mortgage financing could provide benefits for agriculture. However, I believe the implementation of such a mechanism should be coordinated with the Farm Credit System to avoid adding further stress to the System's lending activities.

[Questions submitted by Senator Zorinsky to Secretary Naylor and answers thereto:]

Question. The Farm Credit Act specifically provides the Farm Credit Administration with the authority to establish standards and criteria for pre-approval of many actions by the System now requiring individual approval by FCA. How far are you willing to go in using this authority to lessen FCA's role in the day-to-day management of System affairs and when might we expect you to start taking advantage of this authority?

Answer. Under the 1985 Amendments, the FCA can adopt regulations that confer approvals on actions by System institutions that meet standards and criteria established by the agency. Once the new Capital Corporation is fully operational, FCA will develop regulations and standards to remove the agency from many of the individual prior approvals that are currently required.

A more arm's-length relationship between the FCA and the System was created in the 1985 Amendments. The leadership structure of the agency has been modified to provide greater distance from the System. As the FCA fully implements its expanded examination authority and strengthens its examination function, it will be in a position to utilize new regulatory enforcement powers to bring about correction of unsafe and unsound practices within System institutions.

Question. Do you intend to use your power to set System interest rates in such a way as to control the level of profit/loss in the System and its overall capital position?

Answer. I do not believe that it is appropriate for a regulatory agency to intervene in the internal affairs of a System institution so long as it operates in a safe and sound manner. Institutions that are insolvent or otherwise fail to maintain adequate capital levels will be expected to satisfy the requirements of the Farm Credit Act and develop an acceptable financial plan that describes the means and timing to achieve an adequate capital level. These institutions will be expected to fulfill the terms of their plan. The Farm Credit Administration will utilize all authorities that Congress has given it to ensure that System institutions operate in a safe and sound manner.

As you are aware, the System suffered substantial losses last year. Obviously, these losses cannot be recovered from earnings in the short run. However, I would expect the System to set interest rates that recognize the financial condition of the System and limit additional losses to the extent possible.

Question. The Farm Credit Amendments Act of 1985 sets out several preconditions that have to be met before Federal assistance can be sought. One of those preconditions is a determination that further contributions by System institutions to System self-help would "preclude such institutions from making credit available to eligible borrowers at reasonable terms." Please tell the Committee how you would interpret "reasonable terms" as used in the Act.

Answer. Reasonable terms means the adequacy of all conditions, requirements, responsibilities imposed, and benefits derived by a borrower as a result of the extension of credit by a lending institution. Whether or not terms are reasonable is not measured at a point in time but over the term of the lending agreement. A Farm Credit institution's terms may be very reasonable at one point and less so at another, often due to factors not under direct control of the institution.

The primary example of this is an institution's cost of obtaining funds. To remain solvent in the long term, the System must charge its borrowers more than it pays to obtain funds. If it does not, the institution will fail. At times, the rate charged to maintain this long-term solvency has been very advantageous to the System's borrowers. At other times, it has not. The measurement of whether the terms are reasonable should consider both sets of circumstances.

In considering both, short-run costs can be overcome by the benefits derived over the longer haul. Less than favorable terms and conditions for borrowers in the near term that contribute to the overall financial health of the lending institution and ensure its capacity to extend favorable terms in the long run can be reasonable.

Question. With the Capital Corporation now in place, do you foresee any circumstances under which an association will have to be liquidated by FCA rather than receive financial assistance from the Capital Corporation?

Answer. Liquidation of associations has been and continues to be regarded as a last resort effort to limit losses to the shareholder-members of an association. The

ability of the Capital Corporation to purchase nonaccrual assets and provide financial assistance substantially reduces the likelihood of liquidations of individual banks and associations. However, the System's ability to provide assistance is limited by its available capital and reserves. It is possible that an extreme case may arise where an institution is found to be in such serious financial condition that the cost of assisting it makes liquidation the only practical alternative.

Question. Mr. Secretary, during the hearings before the House Committee on Agriculture on the Farm Credit Amendments Act of 1985, you stated the following regarding the System's Capital Corporation: "It is a complex, difficult, and potentially contentious operation the Capital Corporation faces. The importance of recognizing it as an integral part of the System in all respects is critical." Your colleague, Mr. Sethness, the Assistant Secretary for Domestic Finance at the Department of the Treasury, stated the following: "Part of the effort here is to separate an operating entity from a regulator. We think it would be a mistake to confuse those two roles again and run the risk that Farm Credit System local institutions should end up with two regulators rather than one."

Mr. Secretary, is it still your view that the Capital Corporation should be able to operate independently and be able to make available direct financial assistance independently of FCA's approval?

Answer. It continues to be my view that the Capital Corporation should be able to provide financial assistance without intervention by FCA except in most unusual circumstances. Under the regulations issued by FCA, the Capital Corporation may determine the amount, timing, and form of financial assistance up to the amount necessary to restore any impairment to capital stock and participation certificates. After the Capital Corporation has purchased nonaccrual assets and restored impairments to capital stock and participation certificates, most institutions should be able to return to full viability. Notwithstanding this latitude, FCA also has a responsibility to the Congress to assure that System resources are used prudently so long as any possibility exists that Federal assistance will be needed. To be effective in carrying out this responsibility, FCA needs to be in position to move swiftly. It has therefore preserved the right to intervene if it believes assistance is being extended in violation of the regulations or resources are not being used prudently.

Question. Over the last fifteen months, the Farm Credit System has lost about $13 billion in loan volume. In your view, what has been the reason for this, and what, if anything, should FCA be doing to assist the System in stopping this outflow of good loans?

Answer. There appear to be several reasons why the volume of loans has declined during the past 15 months. First, as agricultural producers encountered adversity, they scaled down their operations and delayed purchases. These actions have reduced the amount of credit needed by farmers. Second, some government programs such as FmHA and Commodity Credit Corporation lending have grown substantially, thereby reducing the level of credit outstanding through commercial lenders. Commodity Credit Corporation volume nearly doubled, increasing by $8.6 billion in 1985 alone. Third, some of the decline results from loan chargeoffs and transfers of loans to acquired property. Finally, the level of interest rates primarily in the FLBs has caused some borrowers to pay off loans by obtaining credit elsewhere or by using cash reserves. For this latter category, we will continue to encourage System institutions to make greater use of such programs as matched funding and differential interest rates to retain high quality loan volume.

Question. The Farm Credit Amendments Act of 1985 consolidated the revolving funds that previously were under the control of the Governor of the Farm Credit Administration into about a $200 million fund available to the FCA board to use to assist the System. Under what conditions would you make use of these funds to assist the System and how would you envision their being used?

Answer. The newly consolidated revolving fund is made available for the Farm Credit Administration to make investments in the Capital Corporation as the FCA deems necessary, to carry out the purposes of the Act. While I cannot speculate on the specific instances when an investment in the Capital Corporation would be necessary, this determination would certainly have to take into consideration the extent to which the System had committed its own resources to the Capital Corporation, the need for additional resources, the availability of funds from other sources, and the extent to which the revolving fund could provide a meaningful solution to the financial situation then existent.

Question. It is my understanding that there is presently in place an Administration coordinating committee composed of policy level staff from the Department of Agriculture and the Department of the Treasury. The committee meets on a regular

basis to review the activities of the Farm Credit Administration. Is this committee going to continue to meet after the Senate confirms the FCA board chairman?

Answer. The Administration coordinating committee was set up to provide communication and assist in an orderly transition in the agency's policy board, as called for in the 1985 Farm Credit Amendments Act. There is no need for that particular committee to continue functioning once the FCA Board is confirmed.

Question. I understand that FCA issued a directive on February 14, 1986, stating that no System bank or association could make any business decision that has the effect of dissipating the institution's existing capital resources, decreasing its revenues, or otherwise diminishing its capacity to provide financial assistance to other System institutions. Would you interpret this directive as limiting the System's ability to restructure loans by writing down interest rates or writing off loan principal since clearly these actions might reduce earnings and dissipate capital? Please be specific as to what the System can do under this directive to restructure loans without prior approval from FCA.

Answer. This directive dealt with System bank and association practices outside the normal course of business that have the effect of dissipating the institution's existing capital resources. The directive does not prohibit System institutions from restructuring loans or participating in state and Federal programs that encourage such restructurings. In fact, on April 22, 1986, each Farm Credit bank was notified that participation by System banks and associations in the Farmers Home Administration interest rate buydown program, which requires debt restructuring and reduction in the interest rates charged, does not require FCA approval under the directive you cite. Restructuring of loans by Farm Credit System institutions is not prohibited by FCA within the normal course of business.

[Questions submitted by Senator Leahy to Secretary Naylor and answers thereto:]

Question. As FCA is responsible for establishing the criteria for equitable loss sharing, I would like you to explain for this committee how you would suggest that the terms "viability" and "competitiveness" be defined for contributing institutions?

Answer. Viability refers to the ability of a System financial institution to continue to provide financial and credit services to its borrowers. Largely this ability is a function of the capacity of an institution to fund itself. Aside from retained earnings, funding is derived from two main sources, the Nation's financial markets, in the form of debt obligations, and the institution's borrowers, in the form of capital stock. An institution's viability can be lost if either of these two main sources of funding lose confidence in the institution and are no longer willing to provide the funds it needs to operate.

Through the action of the Congress, the System has the tools in the Capital Corporation to prevent the loss of confidence by either the stockholder or the investor in debt securities. If the System employs these tools effectively, viability of individual institutions should not be a major concern unless viability of the entire System is threatened.

Competitiveness is more difficult to define, particularly in institutions that face the financial difficulties with which the Farm Credit System must deal. The Farm Credit System's greatest advantage in pricing competitively is its funding source—direct access to the Nation's financial markets. To protect this competitive advantage, the System must demonstrate effective use of the assessment and assistance tools the Congress has given it to prevent the failure of individual institutions.

Question. As a condition of equitable loss sharing, is it your opinion that all the Farm Credit System lending institutions within a District should be required to assist themselves before being allowed to seek financial aid outside the District?

Answer. I don't believe a district should be required to drain its resources before having assistance from other districts become available. I think equitable refers to the ability to share the burden of assisting financially troubled banks on a fair and even basis. The current contractual bank loss-sharing agreements don't work on a district-first basis.

The severity of the problems facing farmers varies greatly between various parts of the country. I think it makes sense to get assistance from System institutions across the Nation, rather than shouldering the burden of a failing bank on others within a troubled district. In many instances, the other banks of associations in the district are not in substantially stronger financial condition anyway. So their capacity to assist is limited. In Omaha, for instance, where two banks are in serious trouble, the capacity for contributions is quite restricted. Would it be productive to draw all the financial resources out of the Omaha Bank for Cooperatives? I think not. I feel the system should use its regional diversity to its advantage.

Question: The 1985 Amendments provide for a pooling of the system's resources through the Capital Corporation, which has recently been chartered and begun to operate. What is the status and future role of the loss-sharing agreements that the farm credit system has used in the past to provide funds to troubled system institutions?

Answer. Until the Capital Corporation is operational, all agreements to share losses that have been in effect for a number of years should continue to be used to prevent severely troubled System institutions from becoming insolvent.

However, once the Capital Corporation is operational, there is little need to continue the present agreements and they should be terminated. It is quite clear that the Capital Corporation will be much more effective at resolving an institution's financial difficulties than are the present agreements.

By purchasing the eligible loans and properties held by troubled institutions and providing a minimal amount of direct financial assistance, the Capital Corporation can not only prevent an institution from becoming insolvent but also eliminate the major source of risk to the institution that the high risk assets purchased by the Corporation represent.

Question. Clearly the farm credit system expects to share loan losses among member banks. The recently enacted legislation permits assessments on member banks to ensure solvency of banks experiencing financial problems.

Some of the member banks are concerned that the assessment power can be used in a way that will result in an overall weakening of the farm credit system. What are your views on the limit for banks on the requirement for contributions to the financial needs of other banks? In your view, when is the limit on a bank's viability as a rural lender reached?

Answer. The Capital Corporation will strengthen, rather than weaken the Farm Credit System by enabling the System to marshal its resources and provide financial assistance to troubled institutions. It is important to consider that the System's institutions share the same vital concern that their source of funding must be protected. The Capital Corporation will help ensure that it is.

There are a number of factors that can influence the viability of an individual institution, including its competitive position, the strength of the local agricultural economy, and the institution's financial resources. However, in large measure, the viability of each institution as a rural lender is tied to the viability of the System as a whole. The System's viability is most readily measured by its ability to attract funds at reasonable rates in the financial markets and to provide credit to eligible borrowers. The Corporation will enhance the System's viability and, hence, that of individual institutions, rather than cause institutions to become nonviable.

[Questions submitted by Senator Harkin to Secretary Naylor and answers thereto:]

Question. What is your assessment of the financial viability of the Farm Credit System over the next five years given the current directions of farm policy? What is your assessment if farm prices stay at or below current levels?

Answer. At this point, I am unable to fully assess the System's financial viability over the next 5 years. There is no question that all agricultural producers, and certainly their lenders, have had to make adjustments to changing world production, prices, and export competition. This is always the case in a dynamic industry.

Because the System is restricted by law to serve only agriculture, its financial condition is more directly linked to profitability in agriculture and changes in farmland values. Much of the readjustment seen today is still the result of inflationary expectations of the late 1970s, not true market conditions for U.S. agriculture. Once I am in the position to better assess the System's financial condition, I would be better able to assess the impact of changing commodity prices on its long-term viability.

Question. Last quarter the system had losses of $206 million, compared to last year's losses of $2.7 billion. Given these conditions, can the System survive without direct assistance from the Federal government? Are there any conditions under which you would feel compelled to advocate Federal assistance for the System? What are these conditions?

Answer. The Farm Credit System will likely continue to face severe financial stress in the near future and may record additional significant losses in 1986. However, the System retains substantial financial resources that if used effectively can help solve its financial difficulties. The Capital Corporation must be properly employed to marshal these resources.

Much also depends on general economic developments, which appear to be improving. Interest rates have fallen; land values are stabilizing; lower energy prices

will reduce production costs; and a decline in the value of the dollar should improve the export outlook. As these economic conditions continue to improve the System's financial condition should stabilize; however, it will take some time for the System to realize the full impact of these improvements.

With respect to Federal assistance for the System, the Farm Credit Act is clear on the conditions that must exist before FCA can certify to the Treasury that the System needs Federal assistance. The System must fully commit its available capital surplus and reserves to addressing its financial difficulties, and further contributions to the Capital Corporation or losses incurred by System institutions would preclude them from providing credit to eligible borrowers on reasonable terms.

Question. Do you believe the System is competitive on interest rates? If so, why are so many borrowers leaving the System? What policy changes do you recommend to remedy this situation?

Answer. The PCAs are competitive with commercial banks. In only three districts do commercial banks have an interest rate advantage over PCAs. The BCs are also competitive with rates charged by commercial banks. While the average seasonal variable BC rates as of May 1 was 9¼, many of the highest quality BC borrowers are being offered matched-funded loans nearer the prime rate.

The FLBs are currently noncompetitive. There are two reasons for this. The first is the higher cost of the FLB debt portfolio. As of late April, average FLB funding cost was 11.2 percent. This average cost has not declined as much as the general market decline in rates, because the System's shrinking size has limited the opportunity to place the lower cost debt into the portfolio. The second reason is the FLB system's heavy volume of nonaccrual loans and the need to provide for its allowance for loss account.

Borrowers are leaving all three systems for three reasons. First, in a few PCAs and in the FLBs, rates are noncompetitive. The second reason is tied to the public's awareness of the System's financial problems. The third is common to all lenders—i.e., the general belt-tightening of farmers and reduction of their debt loan.

The banks and associations have available to them flexibility to deal with their competitiveness problem through the use of differential and matched-funded loan programs. FCA has strongly encouraged the use of these programs. Borrowers are being offered fixed-rate and variable-rate loans in the 9-11 percent range in most FLBs. Borrowers offered these rates are those who present less risk to the institution and are the same borrowers who are most likely to be lured away by competing institutions.

Question. What is your view on how the System has been handling forbearance and debt restructuring? What is your view of the concurrent resolution being offered by Senator Dole and others. What would be your view of making this a binding resolution?

Answer. I agree, generally, with the intent of resolutions that Farm Credit System institutions should pursue a policy of attempting to assist their member-borrowers who face difficulty by providing additional time to resolve problems while carrying out the intent of Congress to maintain a viable credit delivery System.

Specifically, I support the resolution Senator Dole intends to offer.

I would caution against making the resolution binding, however, because that may result in substituting a single approach for the preferred case-by-case business judgment of elected farmer-directors of System institutions.

Question. The Farm Credit Act requires FCA to provide Congress with thirty days advance notice of regulations. The statute also provides that final regulations may be issued on an emergency basis, where appropriate. FCA recently issued regulations pertaining to the formation of the Capital Corporation using this emergency authority. Do you intend to use this authority again with any regulations? If so, which ones? Do you intend to use this authority with respect to capital adequacy requirements? If yes, why shouldn't Congress have advance notice of some kind? Could not an abbreviated time previous be arranged in circumstances where the thirty-day period is a problem?

Answer. It is always possible that circumstances may arise when it is necessary for the Farm Credit Administration to exercise its emergency authority to issue final regulations without prior congressional review.

In light of the strong congressional interest in having the Farm Credit System Capital Corporation operating as quickly as possible, it would be appropriate for the remaining regulations regarding the Capital Corporation to be issued on the same emergency basis as the previously issued Capital Corporation regulations. Although the emergency regulations are effective on publication, the public is provided a 30-day comment period, after which changes may be made.

At the present time, I believe the regulations implementing the capital adequacy provisions of the Farm Credit Act and other provisions of the 1985 Amendments should be issued in accordance with the regular procedures provided for in the Administrative Procedures Act and the Farm Credit Act. Those procedures would provide for a 30-day congressional review period prior to the publication of proposed regulations, an opportunity for public comment on the proposed regulations, and a 30-day delayed effective date.

Question. Given the fact that the 1985 Act provides for a pooling of the systems resources through the Capital Corporation, which has recently been chartered and begun to operate, what is the status and future role of the loss-sharing agreements that the System has used in the past to provide funds to troubled System institutions?

Answer. Until the Capital Corporation is operational, all agreements to share losses that have been in effect for a number of years should continue to be used to prevent severely troubled System institutions from becoming insolvent.

However, once the Capital Corporation is operational, there is little need to continue the present agreements and they should be terminated. It is quite clear that the Capital Corporation will be much more effective at resolving an institution's financial difficulties than are the present agreements.

By purchasing the eligible loans and properties held by troubled institutions and providing a minimal amount of direct financial assistance, the Capital Corporation can not only prevent an institution from becoming insolvent but also eliminate the major source of risk to the institution that the high risk assets purchased by the Corporation represent.

The CHAIRMAN. Mr. Duncan.

STATEMENT OF HON. MARVIN R. DUNCAN, MEMBER-DESIGNATE, FARM CREDIT ADMINISTRATION BOARD, FARM CREDIT ADMINISTRATION

Dr. DUNCAN. Yes, sir. Mr. Chairman, I appreciate the opportunity to appear before the Senate Committee on Agriculture as a nominee on the Farm Credit Administration Board. I am honored to have the opportunity to play a leadership role in the FCA as it regulates and works with the Farm Credit System in solving the System's current financial problems.

The Farm Credit System currently is facing a serious financial challenge. The Farm Credit Amendments of 1985 are very important to the System in addressing that challenge. I pledge my commitment to work for the prompt, full and effective implementation of that legislation's provisions.

These are very challenging times for many farmers, rural businessmen, and for those who share their credit needs. I share your concern, in recognition of the need for our agricultural economy to return to a strong, dynamic, and growing industry.

The cooperative Farm Credit System can make positive contributions to that recovery. I look forward to working with this committee to help achieve that goal. I would like to introduce the balance of my statement into the record.[1]

The CHAIRMAN. Thank you very much, and, without objection, so ordered.

[Questions submitted by Senator Helms to Mr. Duncan and answers thereto:]

CAPITAL CORPORATION WORK OUTS

Question. Would each of you please discuss your views on how the Capital Corporation should be utilized to assist in work-outs for troubled borrowers?

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[1] See p. 55 for the prepared statement of Mr. Duncan.

Answer. In many cases, it will probably be determined, that loans should continue to be serviced at the local level by the originating institution. In those cases, the Capital Corporation can act in a consultative capacity to provide technical expertise to the lender. There will also be instances where a local institution is incapable of continuing to service its troubled borrowers. At such times, the Capital Corporation will have the option of either servicing these loans itself or contracting with other parties to provide continued loan servicing. The Capital Corporation should consider loan reamortization, restructuring, rescheduling or other loan adjustments where that is beneficial to both the borrower and the System institution and should consider liquidation only as a last resort.

FORBEARANCE

Question. We all recognize that the Farm Credit System is a cooperative—owned by its member/borrowers. Therefore, granting special concessions to some borrowers results in additional expense to others. In your opinion, to what extent can the System offer forbearance to troubled borrowers without causing excessive hardship to other borrowers who are also struggling to make payments?

Answer. Because System institutions are operated as cooperatives, loan losses and reductions in loan income cause higher interest rates to be charged to the borrowers who are able to pay their loans. Each loan must be evaluated to determine whether restructuring will ultimately benefit borrowers and the lender or will result in the further erosion of the business and the loan collateral.

SYSTEM STRUCTURE AND FUTURE ROLE

Question. Do you believe there is an ongoing need for the Farm Credit System in its present configuration of district banks and local associations and do you believe it has a significant role to play in modern U.S. agriculture?

Answer. Yes, I believe that modern agriculture needs the access to credit that the Farm Credit System provides. In addition to the System's significance as a nationwide network of agricultural credit cooperatives owned by its borrowers, there is still a need for the System's unique role as a financial intermediator, efficiently channeling capital from investor markets to the agricultural economy. The System's ability to provide a range of credit services to farmers and their agribusiness cooperatives, including real estate financing, on a reliable basis across this Nation is very important to the economic strength of rural America.

ELIGIBILITY FOR FEDERAL ASSISTANCE

Question. In your opinion what specifically would it take to convince you that the Farm Credit System has fully utilized its resources and is eligible to receive direct Federal assistance?

Answer. The Farm Credit System must do all it can to assist itself before it will be eligible to receive Federal assistance. The law passed by the Congress last year requires the System to fully commit its available capital and reserves. There are limitations placed upon contributions that may be required of the banks and associations that possess capital and reserves, but these limitations should be interpreted consistent with the need to fully commit the System's own resources to protect its funding mechanisms before those of the taxpayers are requested.

SECONDARY MARKET

Question. There has been considerable discussion lately regarding the need for a new secondary market to assure the availability of mortgage financing for agriculture. What is your opinion of this idea and what impact would it have on the viability of the Farm Credit System if implemented in the near future?

Answer. A secondary market for mortgage financing in agriculture has much merit. However, if such a mechanism were created it should include the Farm Credit System in a manner that assures it would not have a negative impact on Federal land bank loan volume.

[Questions submitted by Senator Zorinsky to Mr. Duncan and answers thereto:]

FCA'S REGULATORY ROLE

Question. The Farm Credit Amendments Act of 1985 clearly envisioned the Farm Credit Administration being an arm's-length regulator rather than the System's

front office. Too, in the 1985 Act, Congress gave FCA the intermediate enforcement powers it needs to act against System directors and officers who operate in a manner that jeopardizes the soundness of their institutions. Since the passage of the Act, however, FCA has taken a number of actions hardly befitting an arm's-length regulator. FCA has required the System to locate its Capital Corporation in Kansas City, and it has required that the Capital Corporation's bylaws receive FCA approval. Under FCA regulations, financial assistance through the Capital Corporation would be available only under the direction of FCA, and FCA continues to require that every interest rate action of System institutions be FCA approved.

Dr. Duncan, if your nomination to the FCA board is confirmed by the Senate, what actions do you think FCA should take to get out of the day-to-day management of System institutions and to start taking on the role of an arm's-length regulator?

Answer. I believe the 1985 Amendments have placed the FCA in an arm's-length relationship with the System. Of particular significance has been the change in board and senior leadership of the agency. Clearly though, the far reaching changes contained in the 1985 Amendments require a transition period for their full implementation. The FCA has already begun to implement the new relationship through actions such as strengthening its bank and association examination functions, and pressing the need for independent audits of, and accurate financial reporting by, System institutions and through numerous changes in various proposed regulations that have been made available for public comment.

The process of identifying prior-approval areas in the Farm Credit Act that may be handled through regulations and standards has already begun and should be completed as quickly as possible.

Since enactment of the 1985 Amendments, the FCA has spent considerable effort in actions relating to chartering the new Capital Corporation and facilitating its development to a fully operational level. I believe FCA's focus in such matters should be on the need to ensure that the purposes and role of the Capital Corporation as envisioned in the 1985 Amendments are faithfully implemented. The Capital Corporation has a responsibility to the public, as well as to the System, in helping those institutions resolve their financial problems.

REGULATORY ROLE AND INTEREST RATES

Question. The Farm Credit System has expressed considerable dismay concerning the FCA's continued involvement in the setting of System interest rates. What is your view as to the proper role of an arm's-length regulator in the setting of interest rates by the institutions it regulates? In that regard, could you please tell the Committee what authority other regulators of financial institutions have over the interest rates charged by the institutions they regulate?

Answer. I believe the agency must ensure that the System institutions operate in a safe and sound manner and that the congressional intent embodied in the Farm Credit Act and the 1985 Amendments is carried out. The agency is responsible for requiring institutions to maintain adequate levels of capital and for ensuring that the financial resources of the System are committed to achieving the System self-help objectives contained in the 1985 Amendments. In order to carry out these statutory responsibilities the agency must ensure that interest rate programs of System institutions are consistent with the purposes of the Act.

The activities of other Federal financial institutions regulatory agencies that directly relate to interest rates generally involve the rates paid to depositors and other investors. However, like the Farm Credit Administration, those agencies establish capital adequacy levels that impact earnings levels and, as a result, influence the interest rates charged borrowers.

MERGING ASSOCIATIONS

Question. I understand that the FCA regulations for the System's Capital Corporation state that before an institution can obtain financial assistance for the Capital Corporation it must be clear that no other System institution operating under the same title of the act is able to provide adequate services in the territory served by the institution. In your opinion, does this mean that all associations must be merged or consolidated in a district before assistance can be made available through the Capital Corporation?

Answer. The provision of the FCA Regulations to which you refer does not mean that all associations in a district must merge before assistance can be made available. Indeed, mergers typically will be unnecessary. However, in a limited number of cases when an association has deteriorated to a point where stand-alone financial

viability cannot be restored at a reasonable cost, merging may become a practical alternative. I would emphasize, however, mergers are corporate actions that are voted on by the stockholders of the institutions. FCA regulations require full disclosure to stockholders of the facts surrounding a merger.

FCA BOARD PRIORITIES

Question. Dr. Duncan, if your nomination to the FCA board is confirmed by the Senate, which will you view as your greater priority—(1) to do everything possible to prevent the System from going to the Federal treasury for assistance or (2) to assure that farmers have a reliable source of credit at competitive interest rates through the System and to have their investment in that system remain safe and sound?

Answer. I believe the Farm Credit System is important as a reliable source of credit to farmers. Indeed, many farmers have no reasonable alternative to the System as a source of credit services. Moreover, the cost of credit and the safety of member investments are important. Consistent with the 1985 Farm Credit Amendments, the System is expected to fully and effectively mobilize its own resources before any call on public funding should be made.

DECISIONS ON INTEREST RATES

Question. Where do you think decisions are best made regarding what consititutes competitive rates of interest—in Washington or at the board table of the local association?

Answer. There is no question in my mind that a System institution should exercise as much control as possible over its own operations, provided , of course, the institution operates in a safe and sound manner. FCA should interject itself in the operations of an institution only in instances where an institution is not operating in its own or the System's best interest from a safety and soundness standpoint

The establishment of interest rates is clearly a fundamental function of the board of directors of each institution. However, Congress recognized that the Farm Credit System is unique in that its borrowers are also its owners and board members.

Congress authorized the Farm Credit Administration to approve the System's interest rates. More importantly, Congress directed the Farm Credit Administration to cause System institutions to achieve and maintain adequate capital and to consider an institution's capital level when approving actions that could divert earnings, diminish capital, or otherwise impeded an institution's progress in achieving its minimum capital level. So while I believe that the System's institutions should actively manage their own affairs, I cannot overlook the responsibility that Congress assigned the Farm Credit Administration relative to the establishment of interest rates and the requirement to cause System institutions to maintain sound capital levels.

SYSTEM CAPITAL ADEQUACY

Question. It may be that part of the Amarillo PCA's concerns arise from the fact that regulations that would guide the Capital Corporation's assessment of System institutions and which would be used to measure capital adequacy have not yet been issued. Dr. Duncan, what criteria do you believe should be used in guiding the assessment of System institutions and what guidelines should be used in determining capital adequacy? When will these regulations be published?

Answer. The Amarillo PCA has made it clear they are opposed to any assessment by the Capital Corporation or through any other method. For example, Amarillo was a party to litigation challenging FCA's authority to transfer capital among System institutions. This authority was based on regulations issued prior to the 1985 amendments. The Amarillo PCA has also filed a lawsuit challenging the operations of the Capital Corporation and the constitutionality of the 1985 amendments.

The Farm Credit Act requires that the System must have fully committed its resources before seeking direct Federal assistance. The Act does not permit institutions to be assessed to the point that they could not make credit available to eligible borrowers on reasonable terms. Particular emphasis is also placed on the System's ability to obtain funds from the Nation's money markets. Any assessments of System institutions must carefully balance these primary objectives.

FCA is currently working on regulations to implement the assessment authority of the Capital Corporation and the related capital adequacy requirements. Completion of these important regulations is a high-priority item.

EARNINGS

Question. How can the System maintain earnings if its interest rates are held in place at noncompetitive levels?

Answer. The financial stress that has affected virtually all segments of the Farm Credit System over the past 3 years has required many institutions to make difficult and sometimes painful decisions in order to maintain solvency. Maintaining a loan rate that to many borrowers is higher than they would like to pay is one of those difficult decisions that many institutions have had to make. Because the Farm Credit System is the sole source of credit for many borrowers, it is even more imperative that these financially troubled institutions do everything in their power to survive.

On the other hand, System institutions that have not been adversely affected by the adjustments currently occurring in agriculture have a responsibility to aid the System's troubled institutions. Stronger institutions will be required to make some sacrifices to ensure that the financial stress experienced by many System institutions does not result in the loss of the System's funding source. The capital markets, which provide virtually all funds used by the System to make loans, have recognized this relationship for many years since System banks have agreed to joint and several liability for System bonds and notes. Congress formalized this responsibility with passage of the Farm Credit Amendments of 1985, which established the Farm Credit System Capital Corporation.

I have given considerable thought to the possibility of the System substantially reducing its interest rates and thereby attempting to increase its income, as some have suggested is possible. To the best of my knowledge, no System institution has submitted credible evidence to support this argument. Simple arithmetic suggests that a 1-percent reduction in the System interest rates could actually reduce the System's remaining surplus by an additional $400 to $500 million annually, even if some current borrowers were retained. Considering the retrenchment that currently is underway in agriculture, the prospect of gaining enough new loan volume to offset losses of that magnitude seems unlikely.

I am distressed, however, that the System has not used the interest rate programs that have been available and that can permit the System to retain its best borrowers without further damaging its financial condition. The types of programs that can be developed and implemented are:

Different interest rates programs in which borrowers are charged a rate of interest that reflects a thorough analysis of the degree of risk exposure in an individual loan and the borrower's contribution to the earnings of the institution. Programs of this nature have been used successfully by other lenders for many years. Institutions that implement differential interest rate programs are able to offer their strongest and lowest risk borrowers competitive interest rates, thereby retaining loans that might otherwise leave the System. This helps all of the institution's borrowers by improving the institution's earnings base.

Match-funded loan programs match a borrower's interest rate and loan term against a specific bond issue. This allows a borrower to fix the interest rate on a loan for a specific period of time. Programs of this type would require a repayment penalty to cushion the lender's exposure if the loan is repaid before maturity. Because the cost of new bonds and notes is at the lowest level in a number of years, System institutions have an opportunity to provide fixed-rate loans to many borrowers at competitive interest rates.

These programs and variations of them can be used to meet some of the needs of both borrowers and System institutions. A well-managed interest rate program, along with new services to produce fee income, and tight budget control can assist in bringing some interest relief to System borrowers. Unfortunately, few System institutions have developed these innovative new loan programs.

COMPETITIVE INTEREST RATES

Question. FCA's publication "Money and Credit Market Report", dated May 1, 1986, states the following: "A survey of commercial banks with the largest portfolios of loans secured by farmland in each of the 12 Farm Credit districts shows that in every district commercial banks charge a lower rate with the advantage ranging from 50 to 200 b.p. (basis points) before System stock purchase. How do the findings of this survey square with recent FCA actions to deny System applications for the lowering of interest rates?

Answer. The Farm Credit Administration has not denied all requests to lower interest rates. Twenty-three approvals of either interest rate changes or rate policy

changes were granted in response to System bank requests through the first 4 months of this year.

The Farm Credit Administration is charged with causing System institutions to achieve and maintain adequate capital and reserves. When an institution's proposed rate change would diminish its capacity to maintain adequate capital, the result is often a denial of agency approval. FCA denies approval if an institution would be considered unsafe or unsound as a result of lowering its rate.

Requests for interest rate decreases by institutions that have exhausted their earned equity, are on the verge of impairing borrower stock, and require assistance from other institutions in the System can and often do result in denial of approval. In other cases, the agency has denied across-the-board rate decreases in banks that have adequate capital but need to maintain earnings to be able to provide financial assistance to weaker banks. In most instances, these institutions already have rates among the lowest in the System.

SURVEY OF INTEREST RATES

Question. Please provide the Committee with a copy of your recent study on whether the Farm Credit System is interest-rate competitive.

Answer. The agency surveyed by telephone the commercial banks with the largest portfolio of agricultural real estate loans, currently making farm real estate loans, in each of the Farm Credit districts. The survey results are displayed in the following two tables:

TABLE I.—INTEREST RATES ON COMMERCIAL BANK LOANS SECURED BY FARMLAND, APRIL 1, 1986

[Dollar amounts in millions]

District and commercial bank [1]	Loans outstanding—secured by farmland	State	Rate on April 1, 1986—percent	FLB rate April 1, 1986; before stock req.
Springfield—Herkimer Cty. Trust	$8	NY	12.0	12.0
Baltimore—American Bk. & Trust	27	PA	9.5–11.0	11.75
Columbia—Branch Bank & Trust	42	NC	10.0–13.0	12.0
Louisville—Security Bk. & Trust	9	IN	11.5	12.75
Jackson—Grenada Bank	15	MS	11.0	12.25
St. Louis—FNB Arkansas	14	AR	11.0–11.75	12.5
St. Paul—Denmark State Bank	9	WI	11.0	12.75
Omaha—Decorah State Bank	8	IA	12.25	13.25
Wichita—N/A				12.5
Texas—Citizens Natl. Bank	15	TX	11.0	11.5
Sacramento—Bank of America	376	CA	11.0	12.25
Spokane—Seattle FNB (Seafirst)	33	WA	10.0	12.25

[1] Each bank surveyed has the largest agricultural real estate loan portfolios in the district and is currently making long-term loans.
N/A—Not available.

Source: Results of a telephone survey conducted by Farm Credit Administration.

TABLE II.—COMPARATIVE INTEREST RATES: FEBRUARY 1986

[Farm credit banks versus commercial banks]

Farm credit district	PCA	FLB	BC	Commercial ag banks nonreal estate loan rate
1	10.9	12.0	11.25	NA
2	11.25	11.75	11.5	12.09
3	12.83	12.0	11.5	11.89
4	11.81	12.75	9.75	12.64
5	10.76	12.25	11.25	12.29
6	11.45	12.5	11.5	12.62
7	12.25	12.75	11.5	12.6
8	12.41	13.25	11.75	12.0
9	12.5	12.5	10.0	12.87

TABLE II.—COMPARATIVE INTEREST RATES: FEBRUARY 1986—Continued

[Farm credit banks versus commercial banks]

Farm credit district	PCA	FLB	BC	Commercial ag banks nonreal estate loan rate
10	10.69	11.5	11.0	12.23
11	12.0	12.25	10.5	11.75
12	12.25	12.25	11.75	12.25

NA—Not available.

Source: Results of a telephone survey conducted by Farm Credit Administraiton.

[Question submitted by Senator Andrews to Mr. Duncan and answer thereto:]

FCA REVOLVING FUND

Question. Does FCA currently have access to a revolving fund in the U.S. Treasury that would provide funds to contribute capital to the Capital Corporation?

Answer. Yes. The Farm Credit Amendments Act of 1985 merged the revolving fund established by Public Law 87-343, 75 Stat. 758, as amended, and the revolving fund established by Public Law 87-494, 76 Stat. 109, as amended, and continued by Public Law 96-592. The merged fund is available to the Farm Credit Administration for the purchase, on behalf of the United States, of capital stock of the Capital Corporation. That fund has an unobligated balance of $259,798,716.

[Questions submitted by Senator Leahy to Mr. Duncan and answers thereto:]

EQUITABLE LOSS SHARING

Question. As FCA is responsible for establishing the criteria for equitable loss sharing, I would like you to explain for this committee how you would suggest that the terms "viability" and "competitiveness" be defined for contributing institutions?

Answer. The most important factor to focus upon in determining if the System or an individual institution is "viable" is its ability to obtain funds at competitive rates with which it can provide credit to eligible borrowers. The Capital Corporation will preserve each System institution's funding source and, therefore, its viability. However, strongly capitalized institutions will be called upon to share resources with those institutions that are experiencing financial difficulty. Congress directed FCA to develop capital requirements for System institutions and to place limits on the resources that an institution should provide to the Corporation.

Strongly capitalized institutions should be able to provide funds to the Capital Corporation without damaging their competitive position. Contributing institutions may choose to increase their loan rate or to operate more efficiently by reducing operating expenses. However, contributors are sharing their capital with a promise of repayment, if possible, by the Corporation.

INTRA-DISTRICT ASSISTANCE

Question. As a condition of equitable loss sharing, is it your opinion that all the Farm Credit System lending institutions within a District should be required to assist themselves before being allowed to seek financial aid outside the District?

Answer. Institutions within a district should not be required to deplete all their resources before assistance from outside the district is made available. The Capital Corporation, will provide financial assistance to eligible institutions more efficiently than can a single district. It is also important to assure that financial assistance to an association in one district is provided on a basis that is consistent with assistance provided an association in another district. The Capital Corporation is in the best position to provide this assurance. In the long run, it may be considerably more costly to deplete the reserves of an entire district before the Capital Corporation was permitted to provide the financial and technical assistance that Congress intended.

It is more equitable to share the cost of providing financial assistance to troubled institutions among all System institutions, particularly since System banks share the same funding source and are jointly liable for the System's debt. Production credit associations, on the other hand rely on the intermediate credit banks as their

sole source of funds. Therefore, all institutions benefit from a strong System and fairness dictates that they share the cost of assisting troubled institutions.

STATUS OF EXISTING LOSS-SHARING AGREEMENTS

Question. The 1985 Amendments provide for a pooling of the system's resources through the Capital Corporation, which has recently been chartered and begun to operate. What is the status and future role of the loss-sharing agreements that the farm credit system has used in the past to provide funds to troubled system institutions?

Answer. When one speaks of the System's loss-sharing agreements, two different types of contractual arrangements are involved. One type of contract is executed between the associations within a Farm Credit district. A second set of agreements is in existence between System banks. I believe that both forms of agreements should be replaced by the operation of the Capital Corporation's powers to assess System institutions and assist financially troubled banks and associations. This will be advantageous for several reasons. First, the current agreements are flawed. They do not sufficiently spread out the burden of providing assistance. The association agreements are limited to only that assistance available within a district. Likewise, the bank agreements must first completely exhaust the resources of a bank group, FLB, or FICB, for instance, before resources from elsewhere in the Farm Credit System become available.

Second, the Capital Corporation, in addition to providing direct assistance, can help alleviate the cause of an institution's problems by purchasing and working out its problem loans. This can serve to prevent the need for further assistance in ways that the current loss-sharing agreements cannot.

Currently, the System's loss-sharing agreements are being used by System institutions. The agreement between the Federal land banks required loss-sharing contributions to be made at the end of 1985 and again at the end of the first quarter of 1986.

However, as the Capital Corporation becomes fully operational, it will be able to assume the assistance role now performed by these agreements.

SYSTEM INDEPENDENCE

Question. Your prepared text indicates that you intend to work with the administration in overseeing and regulating the Farm Credit System. How do you intend to ensure System independence?

Answer. The 1985 amendments continued the Farm Credit Administration as an independent agency in the Executive branch. They provided for an FCA board whose members serve fixed terms and are appointed by the President. In this manner the structure of the agency is similar to that of the other independent agencies.

The amendments also severed the remaining ties between FCA and the Farm Credit System. In connection with those statutory changes, the FCA must review its regulations and practices to minimize, and eliminate where appropriate, prior approvals and other activities that inject the FCA into the day-to-day management of system institutions.

[Questions submitted by Senator Harkin to Mr. Duncan and answers thereto:]

CONSTRAINTS ON SALE OF ASSETS

Question. What are the legal or regulatory constraints on the sale of assets acquired and held by the System to foreign governments or other interests?

Answer. The Farm Credit Act contains several provisions that would apply to the disposition of assets that are acquired by System institutions. Those provisions would apply to any disposition of assets, including a disposition to a foreign government or other foreign interest. Section 4.35 of the Act provides that no sale of the surface rights to any real property acquired by System institutions may be sold without the sale of the mineral rights to the same person. Section 4.36 of the Act provides that System institutions may not sell acquired real property in a size larger than a normal family farm in the vicinity of the property for an amount less than it could receive from the sale of that property to the Farm Credit System Capital Corporation.

Except to the extent modified by those provisions, each System institution is required to exercise good business judgment in the sale of acquired properties in order

to maximize the return on the sale of those properties and thereby to minimize the loss incurred by the institution and its shareholders. Generally, the private ownership of land is governed by state laws. There are variations among states regarding foreign ownership.

MARKET PRICING

Question. On August 16, 1985, you authored a column in the New York Times entitled "Policy Agenda for Farming". You discussed a wide variety of issues and how they affect agriculture—the deficit, strength of the dollar, tax policy, commodity policy, etc. This was your prescription of what should be done to set agriculture on its proper course.

Of particular note was your advocacy of moving towards "market pricing" while phasing out farm subsidies. Nowhere in your discussion did you mention supply management or what the likely effect of the policy you were advocating would be on farm income. In fact, the term "farm income" never even appeared in the article.

However, I believe you did make reference to what the results of "market pricing" would be when you stated in the article and I quote:

"Large numbers of farmers and rural businesses are likely to be forced out over the next few years."

Was not the pricing policy you were advocating a recipe for the bankruptcy of thousands of U.S. land foreign agricultural producers and ultimately the bankruptcy of the Farm Credit System? Is this not the policy we have now? Do you think it would be wise for a corporation to have as a member of its board of directors an individual who was advocating policies that would result in the bankruptcy of that corporation? Is this not what we are doing here today if we recommend your confirmation?

Answer. I share your concern about the financial plight of American farmers. In the New York Times column you refer to, I out-lined the necessity of a balanced set of broad economic policies to return agriculture to economic health. Those policies can generally be described as conducive to both domestic and foreign economic growth. Improved income in customer countries abroad is especially critical to export demand for corn, soybeans, and wheat—so important to the farm economies of Iowa and other Midwestern and Great Plains states.

Without stronger growth in world export markets and an improved competitive position for the U.S., it would be difficult to project long-term strength in the U.S. farm sector.

More positively, a wise combination of government policies should brighten the outlook for U.S. farmers and for rural America. I wrote of the need for government farm programs—"necessarily generous at first"—to ease a transition toward more market-oriented policies over an extended time frame. The column addresses the question of supply management through a proposal for a long-term land retirement program.

The entire message of the article is that there is a balanced set of economic policies—monetary, fiscal, farm, trade, and economic development—that, if in combination are appropriately used, will return American agriculture to long-run prosperity.

Your question implies my support of farmers and rural businesses being forced out. That is certainly not my view nor the message of that column. Instead, I focused on the unfortunate reality that people were being forced from business and asserted the potential importance of relocation and retaining benefits for such persons.

I understand the important linkages of American agriculture to broader economic and financial policies and am committed to policies that will return American farmers to prosperity and the Farm Credit System to financial health.

The CHAIRMAN. I have two questions that may be pro forma, but they are essential nonetheless. I would pose the questions to the two of you at the same time.

If your nomination is approved by this committee and the Senate, do you promise to respond to requests to appear and testify before this committee, and any other duly constituted committee of the Senate?

Mr. NAYLOR. I do.

Dr. DUNCAN. Yes, sir, I do.

The CHAIRMAN. If you are confirmed by the Senate, will you faithfully execute the laws passed by Congress, regardless of any prior statement you may have made, or biases you may have held?

Mr. NAYLOR. I will.

Dr. DUNCAN. I will.

The CHAIRMAN. Thank you very much. I suggest that perhaps we have a 10-minute time limitation because we want to get on with the other hearing. So, the clock will begin to run, and we will proceed.

Gentlemen, you are going to be serving as the first members of the Farm Credit Administration Board, and, as such, will set the regulatory tone for this agency.

I know this is sort of a broad question, but, as briefly as may be possible, I think it would be important for the record for you to state what regulatory philosophy each of you proposes to bring to the Board; what criteria will you use to distinguish between regulatory issues which are the province of the Board, and general mangement issues which should be left to the System banks to resolve.

I do not know whether that is too much of a question, but take a whack at it.

Mr. NAYLOR. Mr. Chairman, we, very carefully, in working with you during the development of the legislation, structured an organization parallel to the Office of the Comptroller and the FDIC, and other financial institution regulators.

Clearly, it was the intent of Congress that we serve as examiners, and enforce necessary actions to ensure the safety and soundness of the financial operations of the Farm Credit System, and to use those tools to reestablish its strength and viability as an institution.

One of the major changes that occurred in that law was to remove—which was provided under the old authority—the broad notion of general policy supervision of the day-to-day operations of the Farm Credit System by the Federal Farm Credit Board which no longer exists under the new legislation.

That role was an inappropriate role for a regulator, and one in which it should not participate. But under the regulatory guidelines in the law that we must follow, if an individual unit—and by that I mean a district bank, or association, or its management—is engaging in unsound practices, it is not only proper, but we would be negligent, if we did not intervene to whatever extent was required by the authorities you had given to us, to ensure that the producers' and farmers' investment is protected and adequately safeguarded.

To that extent we would find ourselves involved in day-to-day operations, but only in those instances where the safety and soundness of the institution is at issue. You would expect us, I think, to do no less.

Dr. DUNCAN. Mr. Chairman, I share Mr. Naylor's view, that the agency ought to be an effective bank regulatory agency, ensuring the safety and soundness of the Farm Credit System institutions through effective and prudent examination and regulation of that system, operating within the laws that are provided for the Farm Credit System and Farm Credit Administration, and the regulations that the agency crafts to implement those laws.

In so doing, the agency can be of great benefit in bringing a sense of confidence to the borrower/stockholders of the Farm Credit System, retaining their confidence in the integrity of those institutions from whom they borrow, and in which they also are investors.

Moreover, by putting in place financial reporting, and financial disclosure, the management of the institutions, and the directorate of those institutions become more responsive, and more responsible to the borrower/stockholders of the institutions.

The Farm Credit System also has a unique function in that it intermediates funds to rural America through the Nation's capital markets. Appropriate and prudent regulation and examination are essential if the financial markets and those investors who buy Farm Credit System securities are to retain confidence in that System.

The CHAIRMAN. Obviously, one of the most pressing issues facing the Farm Credit System is the question of interest rates. I can certainly understand that many associations have a problem in retaining their "best borrowers" if interest rates offered by other lenders are lower.

We ran into this time and time again in our discussions.

I think it would be important for the record if both of you will discuss your position on recent requests by System banks to lower interest rates. And also, to what extent should the regulator be involved in setting interest rates.

Mr. NAYLOR. Mr. Chairman, this is one of several critical issues to the System at this time. Last September, the System effectively jeopardized its access to the market, and that subsequently led to legislation. One of the great successes of this legislation that was passed by the Congress last December was that it allowed the System to regain access to the marketplace at competitive interest rates, and once again, was able to supply the necessary funds for operation.

With regard to specific interest rates, the result of that legislation made it possible for competitive rates to be developed in the PCA, or short-term lending area, which continues to take advantage of declining rates that are generally occurring in the marketplace.

The System also is competitive in its bank for cooperatives activities with regard to interest rates in the commercial sector, again, the result of your legislative efforts.

The System is not yet, however, fully competitive in the area of land bank lending and long-term real estate lending. This, in large measure, in addition to their problem loans, is a result of a substantial purchase of securities at very high interest rates in the late 1970's and early 1980's, on a long-term basis. They have not yet been paid back, and paid out, so they still impact on the cost of funds to the System.

The System faces some serious problems in the months ahead, and those interest rates, on the overall average cost of funds, are not going to go down as quickly as we would like to see them.

But we need to provide more competitive rates in the land bank area. FCA has properly recommended, very strongly, two courses of action to deal with that problem for the land bank operation. One

is differential pricing which several of the districts currently are offering, which allows them, for their better borrowers, to offer more competitive rates.

A second and perhaps more effective tool is fixed rate loans, something the System departed from some 10, 12 years ago. This can be done on a matched security basis for qualified borrowers in which they can be fully competitive with commercial rates—indeed, in many instances, get in below some of their competitors.

Let me give you a specific example. The recent sale of 5-year securities by the System was sold for about 7.5 percent with the normal add-on for a fixed rate loan. They are in a position, in many districts, to allow for a 5-year fixed rate loan of about 9.5 percent if they elected to do so.

Overall, several of the districts are already offering this type of lending in the range of these rates. Unfortunately, the System has not generally adopted these practices, and has proposed a rather complex methodology which we are reviewing at this time, but may significantly jeopardize their financial soundness. We have to evaluate that, which at a minimum, would require the reclassification of all the loans in the System—a very cumbersome process, I would suggest, at a time when action is needed. We will continue to evaluate that System proposal, but we strongly encourage them to pursue these two alternatives, which allow them to be competitive, to retain good customers, and stem some of the tide that they are facing.

Dr. DUNCAN. Mr. Chairman, I share Mr. Naylor's concern with regard to the System being competitive to its borrowers. Indeed, in my role at the Farm Credit Administration, I have been pressing for the adoption of differential interest rate programs, and fixed rate match-funded programs within System institutions. The agency has approved a number of those proposed plans, where that provides an opportunity for the System institution to be competitive with those borrowers that have other alternatives and might otherwise leave the System.

One of the concerns a regulator always has is the consistency of providing interest rate programs, or approving interest rate programs that reduce income, and at the same time being attuned to the capital position of those institutions. And I share Mr. Naylor's view in that regard.

The CHAIRMAN. Thank you, sir. Senator Zorinsky. My time is up.

Senator ZORINSKY. Thank you, Mr. Chairman. Dr. Duncan, I understand that the Amarillo, TX, Production Credit Association is seeking to remove itself from the System. The Amarillo PCA's intent is to protect its capital from being used to assist other Farm Credit institutions. What would your view be on this?

Dr. DUNCAN. Senator Zorinsky, my understanding of the Farm Credit Amendments of 1985 is that the resources of the System institutions are to be available for the assistance of other weaker institutions within the System that might need assistance, such as the Omaha Farm Credit Banks. We, in the agency believe, and I certainly believe, as well, the Amarillo request has very far-reaching implications for the stability of the Farm Credit System, and hence, the agency has requested a series of hearings around the country. There will be three, one of which was held yesterday.

Those will fully explore the pros and cons of such a request from Amarillo, and at the end of that time, the agency will consider the evidence that has been gathered and make its judgment.

Senator ZORINSKY. Dr. Duncan, inasmuch as the Amarillo PCA established economic gain as a member of the System, do you have any views on the fairness of its leaving the System?

Dr. DUNCAN. Senator, I think it important that the resources of the System be made available to the use of the System in working through its financial troubles. As a senior officer at the agency currently, I want to be careful not to prejudice my view in whatever role I may take in making the decision on the Amarillo request, prior to the time that we have heard and considered the evidence presented at the hearings.

Senator ZORINSKY. What can we do to make Government subsidized loan guarantees and the interest rate reduction program administered by the Farmers Home Administration more attractive to cooperative and commercial lending institutions?

Dr. DUNCAN. Senator, one of the things that the agency can and should do is to press even harder, to remind the System institutions of their responsibility to their borrower/stockholders, to make use of those programs wherever they can be used beneficially, to the support of continued operation of those family farm operations.

We have, in the agency, under my leadership, sent letters to every institution in the System early this year, reminding them of the available Farmers Home Administration programs, urging them to make full and effective use of those programs, and we have negotiated with the Farmers Home Administration, an arrangement whereby most PCA's are granted "approved lender status." That means the paperwork requirements for their using Farmers Home Administration programs are greatly reduced, and thus should facilitate the use of those programs.

I continue to urge System institutions to fully and effectively use those programs in assisting their borrowers.

Senator ZORINSKY. Mr. Secretary, yesterday I sent a letter to Secretary Lyng, requesting that he use his authority to transfer at least $400 million from the Farmers Home Administration Guaranteed Loan Program to the Direct Operating Loan Program.

Have you considered transferring any funds to the Direct Operating Loan Program?

Mr. NAYLOR. Senator, we have not because it appears that the commercial banking system—and I believe that we will aggressively pursue this in the Farm Credit System—will probably fully utilize the guaranteed funds that are available this year.

Over half have now been used and the rate of usage is increasing. We are putting in place a very aggressive additional effort to finish the use of those funds within this lending season.

We had indicated we believed we had adequate direct funds to take us through the spring lending season. We are just barely going to do that. We will find ourselves in some locations out of direct funds before the end of the fiscal year. Now wherever that occurs, we are going to directly attempt to have remaining loans that might be otherwise qualified, guaranteed, and taken by commercial lending institutions.

But we do not, at this time, based on the information I have available to me, have a source of additional funds which might be transferred. And even the emergency lending fund at this point in time, because of the drought in the Southeast, should not be transfered, as we did earlier this year, until we see how it develops.

Senator ZORINSKY. This question is addressed to each of the nominees. As members of the Farm Credit Administration Board, which of the following would you view as your greatest priority: To do everything possible to prevent the System from going to the Federal Treasury for assistance, or to assure that farmers have a reliable source of credit at competitive interest rates throughout the System and to have their investment in that System remain safe and sound?

What are your views on that?

Mr. NAYLOR. Senator, they are entirely opposing questions. The System still has enormous financial strength over and above its members' stock investments. Some $3.2 billion, or a little over that, at the end of this last quarter, as capital in reserves. In addition there are several billion dollars of loss reserves that are at its disposal.

The System has an obligation to make a good faith effort to fully and prudently use the resources it has available to it, and to use them in an efficient and effective manner.

But if I were to list my own priorities of the three issues I think need most urgent attention by the Farm Credit Administration, I would say that in the role of a regulator and examiner, we need to use the full resources of the law you provided us in December, to essentially deal with three points.

One, to ensure that the System fully utilizes its authority to restructure and assist producers in overhauling their loans, and making adjustments accordingly to them, where it is prudent and effective to do so. Second, to put in place competitive interest rates, so that they can maintain a competitive position within the safety and soundness constraints of any financial institution. They can do that. They have already been able to do it in short-term lending, and they have the necessary tools to do it in the long-term lending area. And finally, and perhaps the most difficult, and you, Senator, feel this as much as anyone. A cooperative is only effective as long as it enjoys the confidence and support of its members, and there is clear evidence, that the members of this committee have seen, as we have seen, of a massive erosion of that member confidence. We need to do everything in our power to reestablish it.

Senator ZORINSKY. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator. Senator Boschwitz.

Senator BOSCHWITZ. Frank, I want to return to the Amarillo question——

Senator MCCONNELL. Senator Boschwitz, would you yield to me just for a moment?

Senator BOSCHWITZ. Sure.

Senator MCCONNELL. I commend the nominees, and apologize for not being able to stay. I have a conflicting meeting that I really

must attend, and Mr. Chairman, if I could put my statement in the record.[1]

The CHAIRMAN. By all means. Without objection.

Senator BOSCHWITZ. What can you do? What is the FCA going to be able to do about that member confidence that you spoke about. I think therein lies the difficulty with the Farm Credit System at the present time and will eventually lead to an erosion of its assets; this because of farmers leaving the System. What can you do?

Mr. NAYLOR. I think there are several steps that can be taken. First of all, the System, historically, has not had the kind of examination, and safety and soundness reviews, as other banks and financial institutions have had. As a result their reporting records, or ability to provide sound and adequate financial statements, correct financial statements, does not really exist.

Those things have to be corrected, and the members have to know that their investment is being managed prudently and properly in their behalf.

Senator BOSCHWITZ. How are you going to inspire some confidence in this whole System? I think we have inspired a little confidence, now, by passing a bill that would involve us in the whole process, and so that the cost of money to them is more reasonable, once again. But what can the head of the FCA and one of the other directors of the FCA do to inspire confidence? Just that they are going to be examined more carefully?

Dr. DUNCAN. No. I think that you are asking more of us than that.

Senator BOSCHWITZ. You bet.

Dr. DUNCAN. I think we have to exercise aggressive leadership; that we have to insist not only that we carry out our responsibilities, but that the System utilize the tools that you gave it to deal with its problems. The System must properly use its authorities to work with troubled borrowers and treating them fairly and equitably and where it is appropriate, restructuring loans.

The System should, as quickly as possible, take full advantage of all the authorities they can use to bring interest rates down and reestablish a competitive position that is consistent with safe and sound operation of System institutions.

Senator BOSCHWITZ. Is the FCA going to be in a position to do those kind of things, or, is it only going to act like a bank examiner?

Dr. DUNCAN. Senator, you have given us the power to see that those things are done; if the System resists doing them, we have an obligation to carry out the provisions of the law.

Senator BOSCHWITZ. You bet; you bet. I did not understand that from our conversation at all yesterday, Mr. Duncan. Let me repeat, now, Senator Zorinsky's question. He said he understood that the Amarillo, TX, PCA is seeking to remove itself from the System. What is your view of that? Are you going to wait for months to go by and then review testimony? Is that what you are going to do?

Implicit in that is the entire undermining of the System. Is that either for, or against it?

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[1] See p. 50 for the prepared statement of Senator McConnell.

Dr. DUNCAN. Senator, I beleve the question is directed toward me.

Senator BOSCHWITZ. That is correct.

Dr. DUNCAN. This is an issue of enormous importance to the long-term viability of the Farm Credit System. It is an issue that is going to be tested in the courts of the land. Already the Farm Credit Administration has been sued by the Amarillo PCA.

In dealing with the problem, it is important, it is essential, that an appropriate record be put in place that lays out the problems associated with that request, as well as the Amarillo position, and I believe that the course of action the agency has taken in holding hearings is the most prudent one possible, remembering that whatever decision the Farm Credit Administration makes will be tested in a court of law. It is necessary to build a record upon which that court decision will be made.

Senator BOSCHWITZ. Let me repeat the question. Nobody denies that you have to make a record. Nobody denies that you have to have hearings. What is your attitude, as a director of the Farm Credit Administration, with respect to the removal by a PCA, that it wants to remove itself from the System? You are not going to say anything until all the evidence is in. Is that your position?

Dr. DUNCAN. The removal of, or, the leaving of, from the System of PCA's or banks has the very real probability of undermining the self-help legislation that the Congress wisely passed, and making that legislation far less effective than it would have been, had it been fully used by the System.

I believe that the responsibility of the Farm Credit Administration is to work effectively toward the full and effective implementation of that legislation.

The Capital Corporation is a key feature of that legislation. The Capital Corporation's ability to work out troubled loans, to provide uniform restructuring and reamortization, and assistance to borrowers, and, where necessary, to provide financial assistance to troubled institutions in the System is critically important.

Senator BOSCHWITZ. Quite clearly, some of the districts are not too crazy—did you want to——

Senator WILSON. Could I interject for a moment.

Senator BOSCHWITZ. Go ahead.

Senator WILSON. Thanks. I cannot stay because I have to go to the floor to manage a bill, Mr. Chairman, but I will insert in the record a statement commending Mr. Naylor, who I think is admirably equipped to do this job. I base my opinion on 5 years' experience with him in Sacramento, and not quite that long back here.

He understands the Farm Credit problems and he understands agriculture. The fact that Senators from Kansas, Virginia, and California are claiming him must say something.

Mr. NAYLOR. Thank you, Senator.

Senator WILSON. And with that, thank you.

Senator BOSCHWITZ. Did the Senator——

Senator HARKIN. I just wondered if the Senator from Minnesota can enlighten me. Is the nominee, Mr. Duncan, is he in favor, or would he as a regulator approve of the Amarillo bank leaving the System?

Senator BOSCHWITZ. It is not clear to me. I have a little problem, Senator, getting direct answers from the nominee, and until I get direct answers from the nominee, it is unlikely that I will be supportive of him.

And I got no more direct answer this time than from the preceding one.

Dr. DUNCAN. Senator, let me be very direct, but at the risk that this will be used against me at a later point in court action. I think it would be very unfortunate for the Amarillo PCA, and other PCA's or banks, to leave the System. Instead, they should stay with that System, put their shoulders to the wheel, and work with that cooperative Farm Credit System in resolving these financial problems, so that that System can continue to be an effective credit provider.

Senator BOSCHWITZ. Many districts are not so crazy about the Capital Corporation. They do not like to see their assets, or their own capital go to bail out Senator Harkin, Senator Zorinsky, my farmers—whomever—who clearly are having more trouble than very obviously Amarillo, Springfield, Columbia, or Baltimore, maybe some of the other branches. And so what role do you see the FCA taking in implementing this Capital Corporation which is central to bringing about some of the results and some of the remedies that we have legislated?

Dr. DUNCAN. It is my view, and the view at the FCA in writing the regulations on the Capital Corporation, that the corporation has both a responsibility to the System and a public responsibility, to effectively be a workout arrangement for troubled debt in the System, and to provide reamortization, restructuring, and financial assistance.

Senator BOSCHWITZ. I know what the purpose of it is. How is the FCA going to be able to compel, and what can it do to make the districts put their capital into it?

Dr. DUNCAN. The FCA will enforce the regulations, the law and the regulations that we have written to implement that law, to make effective the Capital Corporation and its ability to assess wealthier institutions for the assistance of weaker institutions.

We have appointed two outstanding gentlemen to the board of directors of the Capital Corporation, gentlemen who have long experience in agrifinance and agribusiness. They are committed to making that Capital Corporation an effective means for providing assistance in the System.

The Farm Credit Administration has the responsibility to approve the Capital Corporation's board's selection of a president for that Capital Corporation, and we will view that responsibility very seriously.

We want a president that will effectively and fully use the authorities of that Capital Corporation, and we will continue to use full moral persuasion and the full authority within the Farm Credit Act to do that.

Senator BOSCHWITZ. On October 31, Governor Wilkinson was here and submitted testimony on the condition of the Farm Credit System and he stated, quote: "Providing leadership and direction is fundamentally incompatible with the responsibility of regulating, examining, and supervising the System. The System must either

provide its own leadership focus or operate without it." Do you agree with that?

Dr. DUNCAN. No; I do not agree with the statement you have read to me. The FCA does have a responsibility to provide leadership. It also has a responsibility to implement the provisions of the law for examination and regulation to ensure safety and soundness.

Senator BOSCHWITZ. Briefly, how do you see the FCA providing that leadership?

Dr. DUNCAN. The FCA through its interaction, its communication with the leadership in the System—senior management, and the boards of directors—can play a powerful and important role by moral suasion and will fully implement the law through regulations, to bring to bear the kind of leadership you and I are interested in seeing.

Senator BOSCHWITZ. How would you, Frank, answer the question, how can the System provide the leadership that would address some of the problems that we have talked about?

Is the FCA just a regulator, or can it provide the leadership, or must the leadership come from within the Farm Credit System itself? What can the FCA do to provide that leadership?

Mr. NAYLOR. The System has the responsibility to provide leadership itself but you are asking, I think, far more of us than that. I think the members of the Board of the FCA, as they are passed through, have a responsibility to provide aggressive and strong leadership to carry out the provisions of the law. And if we are not persuasive, you have provided us with strong enforcement authorities which we will exercise, as you have given us the directive to do as a result of the Farm Credit Act in 1985, and we will use them.

Senator BOSCHWITZ. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Harkin.

Senator HARKIN. Mr. Chairman, if we are coming down the line I will just go ahead and——

The CHAIRMAN. Well, I will do it on the "early bird" basis. You were here first. But whatever. If you want to defer to——

The CHAIRMAN. Now what was that?

Senator ANDREWS. It was off the record.

The CHAIRMAN. You may want to go back to your original——

Senator ANDREWS. I just told Tom he just wanted me to set them up for him; that is all. [Laughter.]

Senator HARKIN. Mr. Naylor, I have a couple of things. I would just point out that section 403 of the Farm Credit Act Amendments that was passed and signed into law on December 23, 1985, stated that it was the "sense of Congress that the pressing needs of the Farm Credit System in the United States agriculture industry require the implementation of this Act as soon as practicable." And that "the President should ensure that the members of the Farm Credit Administration Board constituted under section 2011 are appointed not later than 30 days after the enactment of this act." That would have made it January 23, if I am not mistaken. That is a "sense of the Congress" resolution.

Now here we are at May 23. So, you know, so much for "sense of the Congress" resolutions, as they are looked upon by the administration.

There are two areas I want to go over. The first one, Mr. Naylor, I want to go over with you, is the proposed Farm Credit resolution that Senator Dole was speaking about when he was here.

There is a proposed concurrent resolution. It is a "sense of Congress" resolution just like the one, you know, that said we could have the Board appointed in 30 days. I have looked it over carefully, and Senator Dole is right—I am holding it up. The way it is drafted it is a "sense of the Congress" resolution.

I have also looked over, Mr. Naylor, your Farm Credit System guidelines—I should not say yours—but the Farm Credit System guidelines for restructuring troubled loans that was issued on May 6, just a few days ago. It was transmitted to us here on May 8. Now, I have looked over the Farm Credit System guidelines for restructuring troubled loans, and I have looked over and read every bit of this proposed resolution.

And I would like you, Mr. Naylor, to tell me what the difference in the two are.

Mr. NAYLOR. Senator, I think in part the actions of the System may reflect the potential of this resolution and a similar one on the House side. They are responding to the very real pressure that such resolutions bring to bear on the operating system. Furthermore, it is a first step to correct what I think has concerned us very seriously. The System historically, and particularly within the land banks, has resisted and, indeed, made a practice of not restructuring or reconstituting or making any concessions on any loan.

In good times that perhaps was a satisfactory way of doing business but we are not dealing with good times. The System has had some reservations and has questioned whether that was clearly the intent of Congress with the act that was passed last December.

I intend to use this resolution to make it clear that this is precisely what Congress intended, and then if confirmed, use it as the basis for the agency very strongly to insist that the System make full use of the authorities which you provided it in the act.

Senator HARKIN. If I might interrupt. I asked what the differences were. I still do not know if there are any differences——

Mr. NAYLOR. I am not sure there is a great deal of difference. It is a matter of, I think, reaction to what is in the resolution, frankly, and trying to track that very carefully themselves, and I commend them that they are making that initial step. But I think it is very valuable if the Senate and the House reaffirm your unyielding concern on the issue of proper handling of troubled loans, and that you direct the agency to see that your intent is carried out.

Senator HARKIN. Well, then why shouldn't we make it binding? Why should it be a "sense of Congress"? Why don't we make it a joint resolution and have the President sign it, and make it binding on you, if that is what you need?

Mr. NAYLOR. Senator, the authorities to do everything that needs to be done are in the law that was passed in December. I think that law needs a chance to function, and to demonstrate that it does indeed meet the needs before we start changing it. Second, I would candidly say to you that any resolution of the type you are talking about would be tested in the courts, and might result, because of the wide variances in court interpretations, in a much dif-

ferent ultimate meaning than perhaps even what you might have intended. I do not think that is a prudent course of action, until we have demonstrated that the current law can indeed do the job, which we believe it can.

Senator HARKIN. So what I hear you saying is that you want us to tell you to do what you are already ordered to do by the law?

Mr. NAYLOR. No; I want you to reaffirm to the operating System and the Farm Credit Administration, that insistence upon proper use of the authorities that you have given them is indeed your intent.

Senator HARKIN. But Mr. Naylor, on May 6, the Farm Credit System issued guidelines that tracked this resolution. I can find absolutely no difference whatsoever in the two, and the Farm Credit System says they are doing it.

Mr. NAYLOR. I think the reason they did that is that the System had in their possession this resolution, and perhaps would just as soon that you did not go on the record that you wanted that done. I cannot speak for them——

Senator HARKIN. So they are on the record as saying they are going to do it. So why don't we wait and see if they do it? Now will you carry—if you are confirmed as the Chairman of the Farm Credit Board, will you carry out these guidelines as issued on May 6 by the Farm Credit System? Will you?

Mr. NAYLOR. You are talking about the Farm Credit System, Senator.

Senator HARKIN. Farm Credit System.

Mr. NAYLOR. The Farm Credit Administration will pursue very aggressively a system putting into place the guidelines that are reflected in the resolution. Whether or not it is passed, we would do that; but I think it will add considerable weight to the action of the Farm Credit Administration, if we have the weight of the Congress behind us on that effort, and on behalf of the System.

Senator HARKIN. You have the weight of the Congress. The law was passed last December.

Mr. NAYLOR. Obviously it was——

Senator HARKIN. This was issued on May 6. That is why I do not see any reason for a sense of the Congress. We passed a sense of the Congress that you all ought to be appointed in 1 month, and here it is 4 months later. Again, if you want to put some teeth in this thing, as I said to the distinguished majority leader, I would not be opposed to this resolution if it had some teeth in it, so you will be forced to bite down and do something. But just a sense of the Congress resolution has got a lot of fancy words in there, that track exactly what the Farm Credit System said on May 6. I want to know, if you, as the administrator, are going to carry these out. If you are going to carry them out, then there is no need to pass this kind of fluff and stuff, so that a number of Senators can send out a lot of fancy press releases, saying that the Farm Credit System is going to do something which they are doing anyway.

Mr. NAYLOR. Senator, I think the weight of just the possibility of you doing it is reflected in the issuance. This resolution that you have before you, that Senator Dole has talked about, has been on the table for several weeks, in fact several months, and there was no action outside in the System in general in response to it, until it

became apparent that you were very close to doing something about it.

Senator HARKIN. Well, then it has accomplished its goal, has it not?

Mr. NAYLOR. I am not sure that it has. I think it is still a prudent and a wise step for you to reaffirm your intent, and to give direction to the Farm Credit Administration, that you expect us to aggressively see that the System carries out the intent of this resolution.

Senator HARKIN. I just find it rather odd, that the proposed nominee to be the chairman of the Farm Credit Board would say that he needs Congress to once again tell him to do what the Farm Credit System has already said they are going to do, and which he has every power under the law to do himself, as the Administrator. I find that a very unique position to take.

Mr. NAYLOR. Indeed that is the case, Senator, but I think you are also aware, that if the System undertakes its own efforts and does so aggressively, the time in which it will effectively help the individual producer, which is, after all, what I think we are trying to accomplish, will be much quicker than if we would have to resort to enforcement actions.

I think that both of us have the same objective. We want to see our producers receive the full benefit of the provisions of the law as promptly as possible.

Senator HARKIN. Mr. Naylor, yesterday, I believe you were served with a subpoena, or at least a subpoena was issued by a duly constituted subcommittee of the Agriculture Committee, I believe, or, Government Operations Committee of the other body, subpoenaing you to appear on Tuesday, May 20, at 10 a.m. in room 2247 of the Rayburn House Office Building.

Will you honor that subpoena?

Mr. NAYLOR. First of all, Senator, I have been served no such subpoena. I have been told that perhaps such a subpoena is forthcoming.

I am frankly absolutely appalled that Mr. English took such an action because he never has contacted me, or asked me to appear before his committee, nor have I ever turned him down, for the record.

When Secretary Lyng asked me yesterday afternoon if I would appear, I indicated that I was more than happy to do so, even though Mr. English was well aware that I have no knowledge of the subject matter for which he is asking the hearing to be held and Mr. Lyng has twice, in writing, so advised him, and advised him that the appropriate official, Mr. Amstutz, would be more than happy to make an appearance.

I am absolutely at a loss to understand what purpose Mr. English thinks he is accomplishing. For the record, I would also add that Mr. Lyng and Mr. Amstutz, the responsible officials for this particular issue, appeared in a closed session of the House Agriculture Committee in which this exact issue was discussed in detail for 1 full hour with that full committee, at which Mr. English was present. At that time he did not find it necessary to ask any questions about this issue.

So I have to raise serious concerns as to what the intent or objective of this whole exercise was about.

Senator HARKIN. I see my time is up, Mr. Chairman, but I do have further questions along this line, and I would hope that we would have further time for questions.

The CHAIRMAN. All right. Senator Andrews.

Senator ANDREWS. Thank you, Mr. Chairman. I would like to get into what direction the Farm Credit System will take, and, Mr. Naylor, you are quite knowledgeable about Farmers Home guaranteed loans.

Can you foresee them being used more by the Farm Credit System?

Mr. NAYLOR. Senator, I am going to press very hard for the System to use guaranteed loans from Farmers Home. They should have done that over some time already. Historically, there has been some hesitancy by System management to use Farmers Home guarantees for fear that it might imply that they were a Federal program, or get them too closely linked to a Federal agency. I do not think that is a valid concern any longer. I think guaranteed loans are an effective tool and they must be used.

Senator ANDREWS. Well, it was never a very valid argument. If we have private banks who ask to use them, certainly the PCA's can use them as well.

Mr. NAYLOR. It would do a great deal to improve the operations of the System and the strength of its loan portfolio. I expect to see a very substantial expansion and use of that program, promptly, by the System.

Senator ANDREWS. Now, in the Senate there is a resolution introduced by Senator Dole, others, and myself, concerning the Farm Credit System. One portion of that resolution—and I am sure you have seen it—calls on each System to assure that eligible borrowers and family members of defaulting borrowers, are made aware of and offered the opportunity to participate in bidding on property, subject to foreclosure by the institution. Now, as a regulator, what do you foresee in following this policy of preference to family farmers, if at all possible?

Mr. NAYLOR. Senator, I think that is not only a prudent business practice where the other members are qualified, but it is also good member relations. I hope the System on its own, or, certainly, through strong encouragement and direction of the regulator, would exercise that type of sound membership relations and business practice.

Senator ANDREWS. Let me ask Mr. Duncan: The Farm Credit System is on record favoring loan restructuring over foreclosure, in working out the problems with a troubled borrower. Will you favor such an approach?

Dr. DUNCAN. Absolutely, Senator. I am strongly in favor of the use of that Capital Corporation's authority to fully and effectively implement a program of loan restructuring and reamortization.

Senator ANDREWS. Well, now, loan volume of FCS has declined over $13 billion in the 15 months following the close of 1984. While this may be due in part to farmers tightening their belts, I believe there are borrowers out there who just do not want to pay interest

rates that are above what they can obtain them from elsewhere, and they are leaving, they are moving out of the System.

It is no secret that many of the former FCS borrowers who have left the System are those who are financially strong enough to do this because of their own savings, or by refinancing at lower rates from other creditors. So, the System's portfolio is in effect being downgraded, interest income is reduced, and the ones who are left have to pay more.

Now you have proposed, or the System has proposed measures to be competitive on its rates. FCA has to approve interest rate reductions but it has been slow to respond.

I understand there have been a number of requests for lower interest rates where there has not been that kind of swift response.

Can you assure this committee that FCA will make every effort to address these requests using sound business practices in an expedited manner?

Dr. DUNCAN. Senator, you certainly have my assurance that interest rate requests from the System will be carefully and promptly considered, and the decisions will be made with a view to the benefit of the farmer members and to the capital position of the institutions making the request. Unfortunately, that is one of the responsibilities of a regulator, that they must be aware of and work to maintain the financial stability of the institutions.

There are some excellent opportunities, Senator, for the System to put in place differential interest rate programs and fixed rate matched funding programs that will address the very concern that you have raised. The System has been reluctant and slow to put those programs in place.

Senator ANDREWS. It sure has been slow and that is the thing that bothers me. They talk about the problems. They understand the problems. Nobody has done a darn thing about the problems, and the farmers out there simply do not have that much time to wait, and many of them have been forced off the land because of it.

Mr. NAYLOR. Senator, several of the districts have begun to put in place these fixed rate programs, but they are moving too slowly. As I indicated in an earlier example, in a few districts who are offering those kinds of rates, a fixed rate program for qualified borrowers could produce rates below 10 percent.

Senator ANDREWS. Well, what are you going to do to expedite this? What are you going to do that is different than what has gone before?

Mr. NAYLOR. We have several courses. I hope that the leadership being in place, and working very closely with the management of the Farm Credit System, will produce some positive results on their own; but ultimately, we have the enforcement authorities provided in the law to insist that they exercise sound and prudent management actions, and we intend to use them as needed.

Senator ANDREWS. Do you feel there are some things that you can do, that have not been done before?

Mr. NAYLOR. I feel that without having specific management in place, the System, can justifiably raise the concern whether or not they have clear direction as to what they ought to be doing. That needs to be corrected as promptly as we can, if the Senate feels it is appropriate to do so by putting into place the management of FCA.

Senator ANDREWS. Mr. Duncan, when I asked a minute ago, whether Mr. Naylor supported the family farm preference policy embodied in the resolution by Senator Dole, myself, and others, he said he would support that. Do you feel the same way?

Dr. DUNCAN. Absolutely, Senator.

Senator ANDREWS. Let me briefly, in the time that I have got left, ask either one of you: Where do you anticipate this Farm Credit Administration is going to be 10 years from now, and what are you going to do to move it in that direction?

Mr. NAYLOR. Senator, my hope is that it will be serving as a very effective leader and regulator of a strong and viable Farm Credit System that will continue to be the principal lender to American agriculture. I think that can be done, if we all work together to do so.

Dr. DUNCAN. Senator, I share Mr. Naylor's views.

Senator ANDREWS. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator. Senator Boren.

Senator BOREN. Thank you, Mr. Chairman. I apologize. I might be repetitive. I was in another meeting earlier.

Over the past 15 months, the Farm Credit System loan volume has declined, I believe, by about $13 billion, and part of this is due to the inability of the institutions and the System to be competitive in terms of interest rates.

It is my understanding that since January, the Farm Credit Administration has failed to approve over a dozen requests from Farm Credit System institutions to lower or modify interest rates.

I know one of those requests was from the Wichita district which requested an overall reduction of one-half of 1 percent. They are noncompetitive at this point with a 142 basis point spread.

My understanding was that the reason cited was they had not had enough use of the differential interest rate, which really is not an answer because the overall interest rate is so much higher, that even with a differential they are not able to be competitive.

The second reason was that some of these districts may require assistance from the total System, and of course one of the reasons they are requiring assistance is they are getting in worse and worse shape because they are not competitive in terms of interest rates.

So I direct this to Mr. Duncan in particular. Is the Farm Credit Administration going to be more sympathetic toward the problem of trying to have interest rates that are competitive with other lenders, so that we can hold those borrowers in the System?

Dr. DUNCAN. The Farm Credit Administration, and I, will be very supportive of the provision of credit to farmers at the best possible prices, consistent with, the capital needs of the System.

Currently, the Federal Land Bank System has a lot of very high cost debt in its portfolio. The Federal Land Bank System has a cost of debt in excess of 11 percent at the current time, and those provide some limitations, unfortunately, on the ability to reduce interest rates.

Hence, we have gone to the Wichita Land Bank, and have urged them to propose to us an effective Differential Interest Rate Program, and a Matched Funded Fixed Rate Program. We have told them that we would seriously consider such a program proposal.

We have approved those kinds of proposals elsewhere in the System.

Senator BOREN. You have already spoken about support for restructuring debt as an alternative for foreclosure. In the long-run the System may be much worse off if the high interest rate again causes people to sink, that otherwise might be able to make it with some lower interest rates.

Dr. DUNCAN. One of the useful things that debt restructuring does is to target the assistance to those people who really need it, and who if they receive it, may be able to hold that farm business together and regain financial stability, sir.

Senator BOREN. On another matter, I have been hearing reports that officials from the FCA are meeting with commercial lenders to discuss the possible sale of Farm Credit System portfolio and/or assets.

It is my understanding that some of these discussions have been held with a foreign bank about purchasing Farm Credit System assets. I wonder about the advisability of the regulator in essence, of a borrower-owned and controlled institution, attempting to get involved in the sale of assets of the institution, and I am particularly concerned about it when it even extends to, at least reports of, negotiations with banks in other countries.

Would you comment on the accuracy of these reports, and your feelings about that kind of procedure.

Dr. DUNCAN. Senator, to my knowledge, there are no negotiations being conducted by the Farm Credit Administration with foreign countries or with institutions in foreign countries, with other lenders, regarding the sale of System assets.

I have heard of discussions in the System, between System institutions, and investors. To my knowledge, none of those have gone beyond casual discussions. We have received, at the FCA, no proposal for such an arrangement. I should note one caveat, that the St. Paul Banks have entered into an arrangement with the State of North Dakota in which the Bank of North Dakota provides some assistance to a cadre of farm borrowers in North Dakota.

Senator BOREN. But as far as the Farm Credit Administration itself, you have not entered into, and the Board is not entering into any negotiations of these kinds?

Dr. DUNCAN. That is correct, sir.

Senator BOREN. And I assume it would not be your intent to do so?

Dr. DUNCAN. It probably is an inappropriate role for the regulator to be involved in. The System institutions are the ones that own those assets and are responsible for management of it.

Senator BOREN. I would certainly agree with that. Let me direct this question to both of you. It is my understanding that the Central Bank for Cooperatives has established a highly qualified team to assist in the financing of agricultural exports and I certainly believe the expansion of exports is crucial to the health of U.S. farmers under the situation we now face.

Financing is one of the keys to our future success in agricultural exports. Would you agree that the Farm Credit System can, and should, play a crucial role in this area? I am concerned that in the past, the FCA has not been as flexible as it could have been in sup-

porting the Central Bank's efforts to finance exports, and I wonder if you would, both of you, commit yourselves to doing everything you can to assist the Central Bank in maximizing their role in the financing of agricultural exports, and in assisting with the agricultural export programs?

Mr. NAYLOR. Senator, from my perspective, wherever the bank can effectively serve agriculture it should do so. Currently, it has somewhat limited authority under the law to do so, as you are aware. I believe their current authority sunsets before too long. By and large, most of the individuals involved in export financing are ineligible borrowers for them.

But certainly, to the extent that the Congress has provided authority, we will see that it is properly utilized.

Senator BOREN. Is this something you might examine, both of you, as members of the board, to determine if the Congress should grant additional authorities, or if we should extend the sunset period, or some other provision? I know that is something I would value having your input on, in terms of what you might recommend along those lines.

Mr. NAYLOR. I would be very pleased and pledge myself to sit down with you, and other members, to discuss this in some detail with you.

Senator BOREN. Let me ask this, and I apologize if it has already been asked. We are very anxious to get the full Board in place and to get it operating. It is crucial, with the crisis we face in the whole farm credit area at this time, that we get the full Board operating. Is it your belief that the additional member will soon be appointed by the President, so we can get the full group in place?

Mr. NAYLOR. Senator, I cannot speak for the President, but it is my understanding that the appointment is moving very rapidly. It is the intent of the White House and the President to promptly complete the Board and have it in place, so it can properly function.

Senator BOREN. Thank you very much. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator. That takes us through the first round. I have conferred with the distinguished ranking minority member and I am going to forego the remainder of my questions. I will file them in writing, and ask that you respond in writing.[1]

I in no way want to inhibit the full questioning of the nominees, and will not do so. I would just point out that it is 10:50 now, and we want to get on with the Chernobyl hearing; but I would emphasize that it is not the intent of the Chair to limit the questioning.

Ed and I agree that maybe a 5-minute round would be in order now, and then we will see where we are after that. I pass. I yield to Senator Zorinsky.

Senator ZORINSKY. Mr. Secretary, you have indicated that there are currently sufficient assets that would enable the Farm Credit System to continue to be viable without Federal funds.

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[1] See p. 5.

Last year, Don Wilkinson, when he was serving as Governor, told me how great the System was and how viable it was, and how everything was hunky-dory. Then, we discovered that the System needed emergency legislation.

I don't want to be blindsided again.

Therefore, Mr. Secretary, would you please, for the record, submit to me, to the committee, the total amount of the System's reserves, and your judgment when the reserves might need replenishment with Federal funds.

Mr. NAYLOR. Senator, I will be happy to do the best job I can, and crystalballing into the future. I am well aware of the breach of confidence and support that occurred, when the question was raised last year, whether or not the System, and FCA, had been forthright with this committee, and others in Congress.

I pledge to you that we will work closely together over the years. You will not be blindsided, nor will any member of this committee, or the Congress, be blindsided on the status of the Farm Credit System. They have grave financial problems but they have substantial resources available which the Congress has said they are obliged to use effectively and properly before they seek Federal assistance.

I think you expect us to see that that is done. However, we will keep you closely apprised of the progress. I would also add, that in a letter the agency received from Ed Jones, that a major concern which may ultimately lead to enforcement action, is the apparent inability of the System to provide accurate and sound financial information. They have been unable to do so to date, to the regulator, or others. We have been asked by Mr. Jones, in his capacity on the House side, on the Agriculture Committee, to take aggressive action to see that that situation is corrected, so that the Members of Congress can have an accurate reflection of what is going on. We intend to do so, and the System has already been advised that we expect that to be done.

Senator BOREN. Thank you, Mr. Chairman.

The CHAIRMAN. Now David Stockman is not going to help you with those figures, is he?

Mr. NAYLOR. No, sir. He takes a little different view now, Mr. Chairman. He is in a different capacity.

Senator HARKIN. He has got a different calculator.

The CHAIRMAN. Senator Boschwitz is next, but in his absence, temporarily, we will turn to Senator Andrews.

Senator ANDREWS. Thank you, Mr. Chairman. Briefly—and I had thought this question might have been asked, but it has not been—the problem is assuring FCA with sufficient capitalization for a low assessment formula. One way to do it is by using the FCA revolving funds.

In the Farm Credit Act of 1971, as amended, the Department still holds the revolving funds, and the 1985 amendments, as you know, contain language in section 101, to make these funds available for the Capital Corporation.

Now, I understand the first meeting of the Capital Corporation was held on April 10, yet I understand the rules concerning capital adequacy and the assessment formula are not yet in place. Is that correct?

Dr. DUNCAN. That is correct, Senator.

Senator ANDREWS. What level of capital adequacy would be sufficient for the Capital Corporation?

Dr. DUNCAN. You have asked me a technical question that I am not able to respond to in detail. We are in the process of preparing, and almost ready, to send to the Senate Agriculture Committee, the regulations on capital adequacy for the Farm Credit System institutions.

Senator ANDREWS. When will we get those regulations?

Dr. DUNCAN. We anticipate that they will be to you before the end of May.

Senator ANDREWS. The fact that you are sending them up would indicate that you feel there is an insufficiency of capital adequacy?

Dr. DUNCAN. No. The Farm Credit Amendments of 1985 require that the Farm Credit Administration develop those standards.

Senator ANDREWS. I know that, but do you consider we have adequate sufficiency in the capital?

Dr. DUNCAN. In the Capital Corporation, Senator?

Senator ANDREWS. Yes.

Dr. DUNCAN. The Capital Corporation is not going to, under the terms of the law, be deprived of capital and the necessary resources to provide restructuring and assistance in the System, as long as it is able to use the resources from the wealthier institutions.

Senator ANDREWS. OK. Well, that gets us to resources from the wealthier institutions. That talks about the flight out by some of the wealthier ones.

What level of assessments do you envision as being necessary for the System?

And that is what is scaring the "bejavers" out of some of those people out there.

Dr. DUNCAN. I, at this point, am unable to give you a firm and definitive answer on that, because those regulations are not yet fully completed.

Senator ANDREWS. Do you envision using the Farm Credit Administration revolving funds to invest in the Capital Corporation?

Dr. DUNCAN. That certainly is a possibility, if it becomes necessary.

Senator ANDREWS. Do you think there will be any necessity for Treasury's approval if such funds were to be utilized? I understand there is $148 million or more of funds.

Dr. DUNCAN. A relatively small amount is currently in that revolving fund. That is a technical question to which I think I had better respond to you in writing, Senator.[1]

Senator ANDREWS. Well, then let's get to the base question, the final question. How long does the System have to wait in order to get the final regulations to come out on the assessment formula, so everybody knows where they are at and in what direction they are going?

Dr. DUNCAN. The capital adequacy regulations and the assessment part of the Capital Corporation regulations will be ready at the same time.

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[1] See p. 17.

Senator ANDREWS. The end of this month.

Dr. DUNCAN. And the reason for that, them coming out together is, that of necessity, they have to mesh together. The capital assessment regulations will go out on an emergency basis as did the balance of the Capital Corporation regulations, so that the Capital Corporation suffers no delay in being able to fully implement its authorities.

The capital adequacy regulations will go out in the normal proccdedure, and that means they will come up to the Senate and be available to you on this committee. They will then go out for public comment.

Comments will be incorporated into those regulations, and after that has been done, they will come back to the Congress for a period of time before becoming final.

Senator ANDREWS. Well, time is of the essence because there is a great deal of concern, and shall we save, nervousness, out there in the field. That is why certain units are wanting to get out; that is why the better borrowers are wanting to get out. And the sooner you can put down these ground rules, so everybody knows where they are, the sooner you will begin calming the System down.

Dr. DUNCAN. You are absolutely right, Senator.

Senator ANDREWS. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator. Senator Harkin.

Senator HARKIN. Thank you, Mr. Chairman. Mr. Duncan, have you yourself ever had any discussions with any foreign interest, government or private, about the possibility of buying a portion, or any portion, of the Farm Credit System loan portfolio?

Dr. DUNCAN. Rabobank representatives came by the Farm Credit Administration and informed us that they had an interest in speaking with the System about the possibility of providing credit assistance to farm credit institutions. We told them that was a matter to be handled between the System institutions, who own the assets, and Rabobank representatives.

Senator HARKIN. What bank is that? What bank?

Dr. DUNCAN. Rabobank.

Senator HARKIN. Where is that, now?

Dr. DUNCAN. That is a Dutch farm cooperative bank.

Senator HARKIN. Would you answer the question, Mr. Duncan. Have you yourself, personally, had any discussions with that bank?

Dr. DUNCAN. No, not beyond their coming in and telling us of their interest, and we telling them that is something on which they need to deal with the System institutions. We are the regulator. The System institutions own those assets and are responsible for the management of them.

Senator HARKIN. They discussed this with you, though?

Dr. DUNCAN. They told us of their interest in discussing with the System institutions.

Senator HARKIN. I think we are using the word "us." Were you involved in those discussions?

Dr. DUNCAN. I sat in on those discussions—that is correct—in which they told us of their interest, and we told them of the need to, if they wished to pursue discussions, to visit with the System institutions that owned those assets.

To my knowledge there have been no serious negotiations with them, or with anyone else.

Senator HARKIN. How many times did they come in to meet with you?

Dr. DUNCAN. Once.

Senator HARKIN. And how long ago was that?

Dr. DUNCAN. It is within the last month. Probably 3 to 4 weeks ago, as I recall.

Senator HARKIN. How long have you been at the Farm Credit Administration?

Dr. DUNCAN. I have been at the Farm Credit Administration since mid-August 1985.

Senator HARKIN. Prior to mid-August 1985, had you yourself had any discussions with any foreign interests, Government or private, about this?

Dr. DUNCAN. No.

Senator HARKIN. So you are saying—and you have given your view; you have said that they should contact the System. Let me ask you what your view would be of such a scheme. What would be your view of the Rabobank Bank providing credit to the Farm Credit System?

Dr. DUNCAN. I think that one has to wait to see what proposal may be proposed to System institutions, and what the System institutions' reaction would be to such a proposal.

The Farm Credit Administration, under some circumstances, might be involved in approving such an arrangement, if the arrangement fell within the law, or the regulations of the Farm Credit Administration; and particularly that might be true if there were to be a contingent liability to a Farm Credit System institution upon sale of such assets, or upon a sale of interest in such assets to another institution.

Senator HARKIN. Now tell me if I am wrong, but what I hear you saying is, that there might be circumstances under which it would be advisable to change the regulations?

Dr. DUNCAN. No, sir. I am saying instead, that it is conceivable that the arrangements that would be produced between another institution and a System institution——

Senator HARKIN. Another institution being a foreign bank?

Dr. DUNCAN. Or a domestic bank.

Senator HARKIN. I am talking about a foreign bank.

Dr. DUNCAN. OK. That it could require regulatory approval by the Farm Credit Administration. In the absence of knowing anything about the kinds of proposals that might be in discussion—if indeed they are—I am unable to tell you what the nature of that arrangement, if any, might be.

Senator HARKIN. For a foreign bank to be involved in buying a portion of the Farm Credit System loan portfolio, to your knowledge, would that require any regulatory changes?

Dr. DUNCAN. That is a technical question to which I do not know the answer, Senator, but I would be pleased to find out and respond to you in writing.[1]

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[1] See p. 18.

Senator HARKIN. Let me just ask you from a philosophical standpoint. Would you be opposed, or would you see nothing wrong—would you see nothing wrong with a foreign bank, Rabobank Bank, for example, from The Netherlands, buying a portion of the Farm Credit System portfolio? That does not bother you?

Dr. DUNCAN. I would prefer to, that the Farm Credit System work through its own problems. I might note, that Rabobank has been involved in a substantive level with commercial banks in the Middle West in providing credit services to those commercial banks, and I view that as a different circumstance, than the question you have raised about the purchase of loans, where they provide overline credit facility to those commercial banks.

Senator HARKIN. Well, again, I am asking you, as one of the regulators now, I want to know what your possible position would be, because that, again, I think is very important for us to know, what your position would be, if in fact this comes up; as to how you would view the Rabobank Bank—and I use that only because I know they have been involved in trying to purchase loan portfolios from commercial banks in the Midwest.

I do not think they have been too successful so far, but at least they have an interest there. And as you indicated, they have an expressed interest; at least they came by. They have expressed an interest in this, and I would like to know just what your—whether you would look with alarm upon this, or whether this is just something that might be all right.

Dr. DUNCAN. I think it entirely beneficial if the System can work out its own problems within the United States.

Senator HARKIN. I hope so, too. Mr. Chairman, my time is up but I still have a few questions for Mr. Naylor that I would like to propound.

The CHAIRMAN. All right. I tell you what. We are now on a 5-minute round, and we are trying to get to the Chernobyl hearing, but I am not going to inhibit any Senator from getting his questions in. Senator Boschwitz.

Senator BOSCHWITZ. I would like to ask the witness what he would have done—Dr. Duncan, let's presume that you had been either the head of the FCA, or the position that you are now going to assume for the FCA—that you had been there on February 1.

What would you have done in the last 3-month period, that had not been done, or different than has been done? Or what would you do? I would ask my colleague from Iowa to listen, and I have asked the witness, Dr. Duncan, what he would have done. Would he have done all the same things that have, or have not been done, in the 3- or 4-month period since the 1st of February, had he been in the position that he now is nominated for? Or if he had been in Frank's position, for that matter.

Dr. DUNCAN. I would have applied greater pressure on System institutions to utilize the Farmers Home Administration Program. I would have applied greater pressure on the System institutions to restructure farm loans.

I would have applied greater pressure on the System institutions to develop and propose to us differential interest rate programs and matched funded fixed rate programs to the benefit of their borrowers.

And I would also have pressed very hard to get that Capital Corporation fully operational as quickly as possible. The Capital Corporation has held two board meetings, and the System institutions have been thus far, through their representation on that board, somewhat slow in getting the Capital Corporation fully up to speed.

For example, there has not been a permanent chief executive officer selected as yet.

Senator BOSCHWITZ. How would you have applied this pressure? You said you would have put on more pressure to see that they adopt this policy or that policy.

How would you have applied that pressure?

Dr. DUNCAN. Through regulation where regulation is appropriate, and consistent with the law. Through moral persuasion, which is a powerful tool for any regulator. Through communication with the directors on the Capital Corporation that are appointed by the Farm Credit Administration, and through conversations with the directors from the System, who are on the Capital Corporation, expressing the agency's concern about Capital Corporation not being fully up to speed and urging that that happen promptly.

I would have indicated to them that the Farm Credit Administration stands ready to promptly, approve a chief executive officer when that person is selected.

Senator BOSCHWITZ. Thank you, Mr. Chairman.

The CHAIRMAN. Now we are at 10 minutes past. Senator Andrews, do you have any further questions?

Senator ANDREWS. I have no further questions, Mr. Chairman.

The CHAIRMAN. Could you indicate how much longer you will be.

Senator HARKIN. Maybe just a little bit. I hope not too long.

The CHAIRMAN. Ten minutes?

Senator HARKIN. At the most maybe.

The CHAIRMAN. You have got yourself a deal. Senator Harkin.

Senator HARKIN. Thank you, Mr. Chairman. Mr. Naylor, have you personally had any discussions with any foreign interests, government or private, about the possibility of buying a portion of the Farm Credit System loan portfolio?

Mr. NAYLOR. No. I have not.

Senator HARKIN. You were not in the meeting that———

Mr. NAYLOR. No. That would have been inappropriate for me to be in the agency prior to———

Senator HARKIN. Let me ask you how you would feel about—again you will be one of the regulators—a foreign interest, foreign bank like that coming in and purchasing a portion of the Farm Credit System loan portfolio? How do you feel about that?

Mr. NAYLOR. Senator, it is my view that you gave us the authority within the law to keep the responsibility within the System, and the System can solve its own problems. We should make full use of the Capital Corporation. I would be troubled by other alternatives.

Senator HARKIN. I am glad to hear you say troubled. I would hope that I would have heard that from you, Mr. Duncan, but I did not hear the word troubled, or that you would be alarmed, or that you would see that as something that you would come to us seeking some other form of assistance, prior to letting the foreign interests come in and buy up the———

Dr. DUNCAN. Let me assure you, Senator, that I, too, would be troubled.

Senator HARKIN. I just thought that you were a little bit too sanguine about this, about this approach. Now if they want to do it with a commercial bank, that is a different story.

Two other things that I wanted to go on to was the—again, one I think that Senator Andrews just touched on, Mr. Naylor. The Farm Credit Act requires the Farm Credit Administration to provide Congress with 30 days advance notice of regulations.

The statute also provides that final regulations may be issued on an emergency basis, where appropriate. The Farm Credit Administration recently issued regulations pertaining to the formation of the Capital Corporation using this emergency authority, obviously without the 30-day clarification to Congress.

Do you intend to use this authority again with any regulations?

Mr. NAYLOR. Senator, I am not in place yet to know what may still be on the table, but I certainly intend to go through Congress and follow the procedure for congressional review of regulations to the maximum extent possible. My preference would be to do it in all instances.

I know there is some urgency with regard to the Capital Corporation, that some of those regulations be issued on an emergency basis. I am not aware of any others that might have a similar requirement.

Senator HARKIN. Well, let me give you one. Let me ask you: Do you intend to use this authority, that emergency basis authority, with respect to capital adequacy requirements?

Mr. NAYLOR. It is my belief that it is intended to go through normal procedure. I do not see any reason why it should not, although I have not been in place to review the timing schedule, precisely.

Dr. DUNCAN. That is right. It is only the Capital Corporation regulations that would be put in place on an emergency basis, and only because of the urgency in getting the authority in the hands of the Capital Corporation, so it can fulfill its responsibilities.

Senator HARKIN. In light of the agency requirements, do you see no problem in coming to Congress under the normal procedures?

Mr. NAYLOR. I would seek out your comment and review at this committee, and others concerned in the Congress, before we put them in place.

Senator HARKIN. Mr. Naylor, do you believe the System is competitive on interest rates?

Mr. NAYLOR. It has the capacity to be competitive in its short-term lending and bank cooperative operations, and indeed is. It does have problems in long-term lending by their land banks, in part because of the Systems 'drive to expand in the late 1970's and early 1980's, and borrowing very expensive money in order to do that. This left them with some very high-cost securities in their portfolio.

It is my intent—and I think Mr. Duncan's also—to strongly push the System to make full use of fixed rate loans, particularly where they can be competitive, and should be competitive. Some of the districts are doing so very effectively, if they will make full use of those types of authority.

Senator HARKIN. Do you, Mr. Duncan, feel that the rates are competitive?

Dr. DUNCAN. In the case of the PCA's and the banks for cooperatives, they are essentially competitive according to our interest rate surveys. There is a problem in the land bank portfolio and it is premised on the very high cost of the System—of that portfolio for the System, about 11.2 percent at the current time.

Senator HARKIN. I just noticed that the Farm Credit Administration report, the pricing results as of April 29. Your survey of the 12 Farm Credit districts shows that in every district commercial banks charge a lower rate, with the average ranging from 50 to 200 base points. Or one-half to 2 percent.

Dr. DUNCAN. That is the land bank rates versus commercial bank lending or real estate loans.

Senator HARKIN. That is on land banks. That is on the Federal Land Bank; that is right. So, in that area, they are not. This may be my last area, Mr. Chairman. I want to get back to the subpoena that was issued, or that was voted yesterday. I am referring to a statement that was made by the chairman of that committee, who said that:

> This morning, the subcommittee staff

And I am reading here from the statement—

> Was notified by telephone that Mr. Naylor will not honor my request, and will not appear before the subcommittee on any of the dates offered to him.

Furthermore, Congressman English said that he requested of the Department, he asked the Secretary of Agriculture to provide as a witness, the person responsible for the decision to ignore the requirements of the act—meaning what we are talking about. We are talking about the Dairy Termination Program.

So, they sent up various people, and Mr. English said that "Mr. Amstutz told me on the telephone that he did not make the decision. Mr. Amstutz told me that the Secretary of Agrculture was responsible." When the program was instituted, Mr. Naylor was Acting Secretary.

I am rather bothered by this. I do not know where the facts lie, but I am bothered by the implementation of the whole herd buyout program, and what I consider, just what this Senator considers to be a total disregard for the law. I believe this matter really ought to be cleared up, Mr. Naylor, and that is why I was asking whether or not you would appear and honor that subpoena, and clear that up. What bearing does this have on this appointment? Only in that I am concerned that this matter be cleared up and fully aired, so that this cloud is not left hanging, that you, as Acting Secretary, in any way thwarted or tried to countervene the law that was passed by Congress, and I believe that is important for you to do.

Mr. NAYLOR. Senator, I think it is important for the record to show, that I am sorry to say, Mr. English's statements are not accurate.

Secretary Lyng, in writing, on two occasions—and I have not been served, I might add, with regard to this subpoena—advised Mr. English, that Mr. Amstutz was the responsible policy official, and indicated that Mr. Amstutz would be willing to appear before

the committee to answer any questions with regard to the issue being raised.

Mr. English did not accept, apparently, the Secretary's recommendation.

I might also add again, for the record, Senator, that Secretary Lyng and Mr. Amstutz, the responsible policy officials, met in closed session with the House Agriculture Committee for 1 full hour, in which they addressed, in full detail, the subject and issue in your notes there from Mr. English. Mr. English was present. He did not see fit at that time to raise any questions, if indeed he was concerned, and he knows, by official notification from the Secretary of Agriculture, that I participated in no policy meetings, no meetings whatsoever with regard to this subject. He has been so advised, two times, in writing, before he issued that statement.

I take great objection, and am very bothered, that we seem to be engaged in some sort of political situation here that has little bearing to fact, considering that the gentleman in the House was properly advised by the appropriate authority for this administration, that I was in no way involved in the policymaking process of the issue at hand.

Senator HARKIN. Were you Acting Secretary at the time, when this program was instituted?

Mr. NAYLOR. On the day before Secretary Lyng assumed office, I signed, as Acting Secretary, the publication in the Federal Register of the regulations relating to the Dairy Program, after satisfying myself that they had been properly handled through the internal clearance procedures of the administration.

Those regulations, however, do not deal specifically with the issue with which Mr. English seems to be so concerned, and that is the handling of the marketing of animals.

Senator HARKIN. Orderly marketing.

Mr. NAYLOR. That is correct. The documents related to that subject were not issued until March 10, after Mr. Lyng had assumed duties as Secretary of Agriculture. I was in no way involved in any meeting that prepared those, or in which those were discussed at any time. Mr. English has been so advised, repeatedly, by Secretary Lyng, and I am dismayed that he continues to pursue this course of action.

Will I appear before his committee? Certainly, I will. Did he need a subpoena? No, he did not. Did he ask me to appear? No, he did not. Did I turn him down? No, sir. I did not.

Senator HARKIN. Well, Mr. Chairman, I have—as I understand it, that you will comply and you will appear, and get this matter cleared up, and I am glad to hear that.

I am also glad to hear that both of you say you will adhere to the provision of the 30-day advance notice for regulations, especially on the capital adequacy requirements.

We still have not cleared up the matter on the proposed resolution, but that is something that will have to be worked out here. I still do not have a good firm grip on why we should not make it mandatory rather than hortatory, and make it binding as a joint resolution rather than a concurrent resolution.

Mr. Chairman, I appreciate your indulgence. I have a few more questions that I would like to ask but they are the type of questions that could be submitted in writing.

The CHAIRMAN. Very well. Well, that winds up this hearing, and I thank you gentlemen for being here, but I thank you most particularly for bringing your ladies.

So we will recess this executive nomination hearing, and we will have a brief recess so that the hearing room can be cleared of those who are here purely for the executive nominations.

We stand in recess at the call of the Chair, which will be about 5 minutes.

[Whereupon, at 11:20 a.m., the committee adjourned, subject to the call of the Chair.]

[COMMITEE NOTE.—May 20, 1986, the nominations of Frank Naylor, Jr., and Marvin Duncan were reported to the Senate. May 21, 1986, the nominees were confirmed by the Senate.]

APPENDIX

STATEMENT OF HON. BOB DOLE, A U.S. SENATOR FROM KANSAS

Mr. Chairman, I am pleased to join with Senator Wilson and other members of the Senate Agriculture Committee in supporting the nomination of Frank W. Naylor, Jr., as Chairman of the Farm Credit Administration.

STRONG CONGRESSIONAL SUPPORT

I know that many of us on this committee as well as in the full Senate and the House of Representatives are aware of his involvement in developing the farm bill, the farm credit bill and other farm related legislation. I have been personally appreciative of the fine working relationship I have had with Frank and I know other members here would say the same about their relationship with him.

BACKGROUND

Frank is a native of Kansas. His family's ancestors homesteaded there in the 1850's. Frank grew up in Kansas and attended the University of Kansas in 1961. After serving in Vietnam, he moved to Washington in 1969 as Deputy Director of the Federal Crop Insurance Corporation (FCIC). He continued to gain experience as a financial manager by becoming Associate Administrator of the Farmers Home Administration (FmHA) in 1973 and Administrator in 1976.

After 4 years in California with the Farm Credit System, Frank returned to Washington as Under Secretary of Agriculture. This progressive series of responsibilities in the field of agricultural credit has given him a broad background that I feel is essential to anyone taking on the responsibility of guiding the Farm Credit Administration in this time of transition and change and in the years ahead.

POLICY DIRECTION

I indicate that almost all of my colleagues on this committee as well as many other Senators from farm States--61 Senators in total--have joined me in sponsoring a resolution, S. Con. Res. 138, which sets forth policy guidelines which we believe are important for the Farm Credit System and Farm Credit Administration to follow in hopes that a clear direction would be provided to farm credit districts and their member institutions.

Our resolution encourages greater flexibility in the lending activities and regulation of the Farm Credit System to assist farm borrowers through their current period of high indebtedness and tight cash flow.

I have attempted for several weeks to obtain unanimous consent to consider the resolution but was advised on several occasions that there were objections on the democratic side.

I would hope the nominees before us today would indicate their support of the provisions contained in S. Con. Res. 138, including the policies announced by the other Federal regulators in dealing with commercial agricultural banks.

CONCLUSION

Mr. Chairman, I would just conclude by stating that I am very supportive of Frank Naylor's nomination and confirmation as Chairman of the Farm Credit Administration and I will look forward to working with him in that new capacity.

STATEMENT OF HON. EDWARD ZORINSKY, A U.S. SENATOR FROM NEBRASKA

Mr. Chairman, I am pleased that we are finally considering nominations to two of the three positions on the Board of the Farm Credit Administration. It is certainly not the committee's fault that it has taken so long to get to this point. The delay is most regrettable. I firmly believe that the delay has only served to heighten the tension that exists throughout the Farm Credit System.

The enactment of the Farm Credit Amendments Act of 1985 marked a distinct change in the direction of the Farm Credit Administration. It was our intent that FCA become a true arm's length regulator of the Farm Credit System, that it remove itself from the management of the day-to-day operations of System institutions, and that, in effect, it no longer act as the System's front office.

The new FCA board has quite a challenge. It is imperative that the System continue to serve the credit needs of farmers. In my judgement, interest rates charged by the System must come down, and I look forward to hearing from the nominees on how they will help the System in its efforts to bring rates down to competitive levels.

The board will likely be faced with the decision whether the Farm Credit System should obtain direct financial assistance from the Federal Government. We have established the Farm Credit Administration as an independent regulator--independent of the Farm Credit System and independent of the White House. I look forward to hearing the views of the nominees on this subject. I would hope to receive some reassurance that they intend to act with the independence that would be entrusted to them, especially on this subject of financial assistance.

STATEMENT OF HON. RUDY BOSCHWITZ, A U.S. SENATOR FROM MINNESOTA

Mr. Chairman, the Farm Credit System and the Farm Credit Administration continue to face overwhelming financial difficulties. The FCS first quarter report showed another $200 million loss after posting a $2.69 billion loss last year.

Certainly the System, and the FCA, need to turn things around soon or we will be facing a collapsing Farm Credit System and a potential huge drain on the Treasury.

So, while I am very pleased to see these hearings on the FCA Board nominees begin, I want to state at the beginning that I feel very strongly about the qualifications needed for the job.

First, we need candidates with proven leadership ability. For too long the Farm Credit System and the FCA have had a vacuum at the top. Too much infighting and no agreements on how best to adjust to the changing times in agriculture have put the System where it is today. The last thing the System needs is another technocrat or two.

So, what the FCA needs is leadership that is willing to be aggressive--to step in now and move the System in the proper direction.

But equally important, we need candidates who have some understanding and sympathy for the situation facing American agriculture. As farmers and their leaders attempt to work through their current problems, we need leadership which recognizes that we are in a period where buying some time in agriculture is terribly important.

They must remember that a hard-nosed approach based solely on the numbers but ignoring the farmer/borrowers and their community--will do as much harm as anything else the FCA or System can do. And unfortunately, it will burn up something that is much harder to report or replace--namely goodwill.

So, I will be using today's hearing and possible other future hearings to explore these issues in depth. I certainly will not support any nominee that does not meet these two tests.

STATEMENT OF HON. PETE WILSON, A U.S. SENATOR FROM CALIFORNIA

Mr. Chairman, it is with good reason that a number of my distinguished colleagues are proudly claiming Frank Naylor has their own and I am pleased to add California to the list of States that have known the nominee.

For 5 years--from 1976 to 1981--Frank served as Senior Vice President of the Sacramento Farm District. In that capacity, he worked diligently and successfully on our complex farm credit problems. Although he left my fine State in 1981 to join the Administration as an Under Secretary of Agriculture, my constituents and I still think of him as a Californian.

I have worked closely with Frank both during his 5-year tenure in Sacramento and since the two of us have been back in Washington. We have labored together over the frustrating and

difficult agricultural credit situation that concerns us all. It is in great part due to his efforts--particularly last December when the Congress considered and adopted a farm credit bill--that we can point to some success.

In my opinion, the new Chairman of the Farm Credit Administration must be a strong manager, familiar with the complicated workings of the Farm Credit System. He must be able to work effectively with the Administration, Congress, and other public and private financial institutions. Finally, he must understand American agriculture and the difficulties which some of our farmers are experiencing. Mr. Chairman, Frank Naylor meets and exceeds these qualifications.

I am not just pleased to support his nomination, but thrilled that he wants the job. His willingness to serve during a particularly difficult period is reassuring and highly commendable. It is my hope that the confirmation process is swift and my expectation that it will be favorable. I look forward to working with Frank as Chairman of the Farm Credit Administration.

STATEMENT OF HON. MITCH McCONNELL, A U.S. SENATOR FROM KENTUCKY

Mr. Chairman: I cannot emphasize enough the urgency which must be attached to prompt consideration of the nominations of Frank Naylor and Marvin Duncan. Both the Farm Credit System and the Farm Credit Administration are "floundering in the water", so to speak, simply because right now no one in either the FCA or FCS is willing to accept a firm leadership role. We must act expediently so that the Farm Credit System and the FCA can begin to work together for a change.

Mr. Chairman, it also should be noted here that the third nominee to the Farm Credit Board has apparently not been officially named. Although my distinguished colleague on this committee from Oklahoma, Senator Boren, may be privy to some information that I don't have, it is my understanding that a background check is being conducted on a potential candidate. Again, a sense of urgency must be attached to moving this nomination along as quickly as possible. About 3 week ago, Senator Quayle and I initiated a letter to the President from Senators whose States comprise the Fourth Farm Credit District asking that he quickly nominate someone to fill the third spot on the Board. In a reply from Bill Ball on the President's behalf, I was assured that filling this slot is a high priority at the White House. I certainly hope so.

The nominees who are appearing today are, in my judgment, imminently qualified to take on the difficult task of rebuilding the damaged Farm Credit System. Their jobs will not be easy; employee morale within the System is at an all time low and borrower confidence is practically nonexistent. Clearly, now is the time for forceful, aggressive leadership which I'm confident Frank and Marvin can provide.

Mr. Chairman, Frank Naylor and Marvin Duncan are not strangers to the members of this committee. Both have long and distinguished careers of service to agriculture. Both are commited to removing the adverserial relationship between the Farm

Credit System and the FCA which has evolved out of the farm credit crisis. There should be not higher priority for this Farm Credit Board than to rebuild the cooperative spirit that has made the Farm Credit System the Nation's agricultural lender.

As I said before, Mr. Chairman, this task is formidable. However, Marvin Duncan made an interesting comment to me when he stopped by my office a couple of weeks ago on a courtesy call. He said that he had turned down several opportunities to come to Washington to work at FCA because he wasn't sure he agreed with the direction the FCA was moving. Now, Marvin, you have an opportunity to establish your own direction. For the sake of thousands of farmers in rural America, I hope it's the right one.

Again, I want to lend my enthusiastic support to these two nominations which are before us today. I look forward to hearing what they have to say about what's gone on in the past, what has worked and not worked, and what substantive changes in the mission of the Farm Credit System must be made. Thank you, Mr. Chairman.

STATEMENT OF HON. PATRICK J. LEAHY, A U.S. SENATOR FROM VERMONT

Mr. Chairman, this hearing begins the process that will lead to the appointment of a Farm Credit Administration Board. I hope that the committee will be able to complete the hearing process as rapidly as possible, given the importance of these positions.

The committee would be able complete the process more expeditiously, of course, if the President had announced all three of the nominees. I urge the President to announce the third nominee for the Farm Credit Administration Board soon.

Frank Naylor is well known to the members of this committee. I think it is fair to say that we all have a high regard for his knowledge of the Farm Credit System and all other aspects of farm and rural lending. I will have some questions for Mr. Naylor later.

Marvin Duncan is another candidate with impressive credentials for membership on the FCA Board. Most recently, he has served ably as Senior Deputy Governor for the Farm Credit Administration. I will have question for Mr. Duncan as well.

Mr. Chairman, I hope that this morning's meeting will mark a good beginning for the confirmation process.

STATEMENT OF HON. ALAN J. DIXON, A U.S. SENATOR FROM ILLINOIS

Mr. Chairman, I am pleased to be here this morning as the Senate Agriculture Committee considers the nominations of Frank Naylor and Marvin Duncan to be Members of the Farm Credit Administration Board.

The Farm Credit Administration Board was authorized in the farm credit bill passed by the Congress last December. I am anxious for these Members to begin their work on the Board. I feel they can play a vital role in protecting the interests of both the farms and lenders.

Mr. Chairman, yesterday the House passed a resolution which urged the Farm Credit System to work to restructure farmers' loans rather than foreclose. Over the past year, as the crisis in our Nation's agricultural sector has deepened, the health of our agricultural lenders has been put in jeopardy. As the only Member of Congress to serve jointly on the Agriculture and Banking Committees, I have been particularly aware of this critical problem.

Last year, at this time, I introduced a farm credit bill, which was referred to the Banking Committee. This bill would give farmers and bankers the flexibility they need to restructure farmers' loans. This legislation is now pending on the Senate calendar. In the meantime, I am pleased to say that the Federal Deposit Insurance Corporation (FDIC) and the Comptroller of the Currency have put into effect some administrative changes along these same lines. I am hopeful that the Farm Credit System, and the Farm Credit Administration will also take the proper steps to assure that farmers have the opportunity to restructure their loans.

Mr. Chairman, I would also like to highlight the problem our farmers face with high interest rates. Those farmers, who are in danger of losing their operations, are caught in loans with high interest rates. Some of our farmers are still paying off loans at 13 percent, when they could be restructured at a lower rate with payments they could meet, once they can again cash flow.

I appreciate the opportunity to be here this morning to discuss these vital nominations and look forward to hearing the ideas of both Mr. Naylor and Dr. Duncan, especially in regard to the restructuring of loans and high interest rates.

Thank you, Mr. Chairman.

STATEMENT OF HON. HOWELL HEFLIN, A U.S. SENATOR FROM ALABAMA

Mr. Chairman, I am grateful to see that nominations to fill the Farm Credit Administration Board have finally been submitted to the committee. However, I need not remind any member of the committee that there are three positions to fill and only two nominees, and that the Administration has sent these two nominations up almost 4 months later than the "30 days after the date of enactment" as expressed in the sense of Congress in section 403 of the Farm Credit Restructuring Act of 1985.

It is my understanding that the Farm Credit System has reported another loss for the first quarter of this year. Clearly, the Farm Credit System still faces serious financial problems and will need to look to the new Farm Credit Administration Board for leadership and direction.

I feel it is important that the positions on the Board are filled by qualified people and that the regulations regarding the Capital Corporations and other aspects of the 1985 FCA amendments be issued as soon as possible. But, I am somewhat alarmed by a phrase that I keep hearing over and over about getting everything in place, so the FCA Board can "solve the System's financial problems".

I would like to emphasize that the "System" is owned by its borrowers/farmers, and it is impossible to solve the "System's" financial problems without trying to solve the financial problems of its owners. The financial problems of the owner could best be helped with lower and more competitive interest rates, a little more forebearance with or an opportunity to restrucuture delinquent loans, Production Credit and Federal Land Bank participation in FmHA guaranteed loan programs, and other such programs that are given lip service in the FCA news releases but are not implemented in the district institutions.

Mr. Chairman, I hope that the nominees will keep these points in mind if they are confirmed by the committee and the full Senate body. I look forward to hearing the testimony of Mr. Naylor and Mr. Duncan as well as their responses to the questions of my colleagues.

Thank you, Mr. Chairman.

United States of America,
Office of Government Ethics,
Office of Personnel Management,
Washington, D.C., May 7, 1986.

Honorable Jesse A. Helms
Chairman, Committee on Agriculture,
Nutrition, and Forestry
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

In accordance with the Ethics in Government Act of 1978, I enclose a copy of the financial disclosure report filed by Frank W. Naylor, Jr.,* who has been nominated by President Reagan for the position of Chairman, Farm Credit Administration.

We have reviewed the report and have also obtained advice from the Farm Credit Administration concerning any possible conflict in light of the Administration's functions and the nominee's proposed duties. Based thereon, we believe Mr. Naylor is in compliance with applicable laws and regulations governing conflicts of interest.

Sincerely,

David H. Martin, Director.

Enclosure.

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*Retained in Committees files.

Department of Agriculture,
Office of the Secretary,
Washington, D.C., May 12, 1986.

Honorable Jesse A. Helms,
Chairman, Committee on Agriculture, Nutrition,
and Forestry, United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

On March 3, 1986, I submitted to the Office of Government Ethics a copy of my SF 278, Financial Disclosure Report, required in connection with my nomination to serve as a Member of the Board of Directors of the Farm Credit Administration. The President has also indicated his intention that I serve as Chairman of the Board. That report contained all required financial information for calendar year 1985 and for the current calendar year through March 3, 1986.

The Ethics in Government Act of 1978, as amended, also required that I update certain parts of the information reported on the SF 278, i.e., that required by section 202(a)(1)(A) of the Act, respecting income (other than dividends, interest, rents, and capital gains) and honoraria, to a date which occurs five days before the date of the hearing held by your Committee to consider my nomination. The hearing to be held on my nomination is presently scheduled for Thursday, May 15, 1986. The purpose of this letter is to report that, as of May 10, 1986, I have received no income or honoraria in addition to those categories and amounts of income shown on my Financial Disclosure Report as dated and filed on March 3, 1986.

I trust that this letter satisfies the additional applicable reporting requirements contained in the Ethics in Government Act.

Sincerely,

Frank W. Naylor, Jr.,
Under Secretary of Small Community
and Rural Development.

BIOGRAPHICAL SKETCH OF FRANK W. NAYLOR, JR., UNDER SECRETARY OF AGRICULTURE FOR SMALL COMMUNITY AND RURAL DEVELOPMENT

Frank W. Naylor, Jr., has been Under Secretary of Agriculture for Small Community and Rural Development since May 20, 1981. He exercises general supervision over the Farmers Home Administration, the Rural Electrification Administration, including the Rural Telephone Bank, the Federal Crop Insurance Corporation, and of the Office of Rural Development Policy. He serves on the Policy and Coordination Council of the Department of Agriculture, chaired by Secretary Block, is a member of the Commodity Credit Corporation Board of Directors, and serves as the Department's representative on financial and housing working groups for the Cabinet Council on Economic Affairs.

Before accepting his present position, Mr. Naylor served since 1976 as Senior Vice President of the 11th Farm Credit District, Sacramento, California.

Frank Naylor first came to Washington in 1969 to join the U.S. Department of Agriculture as Deputy Administrator of the Federal Crop Insurance Corporation. In 1972, he moved to the U.S. Veterans Administration as Executive Assistant to the Administrator, where he develop management alternatives for the delivery of improved medical services and other benefits to veterans.

From 1973 to 1976, Mr. Naylor was Associate Administrator and Administrator of the Farmers Home Administration. His work involved managing a nationwide rural credit operation, including agricultural, mortgage, farm and community development loans.

Before coming to Washington, Mr. Naylor was staff manager for the Metropolitan Life Insurance Company In Kansas City, Missouri.

A native of Kansas, Mr. Naylor graduated from the University of Kansas, Lawrence, in 1961. He holds the Navy Commendation Medal, saw combat duty in Vietnam, and is a former national chairman of the Vietnam Veterans Committee. He has been active the American Legion and several civic organizations, including the Chamber of Commerce.

My Naylor and his wife Karen have two children.

STATEMENT OF MARVIN DUNCAN, NOMINEE, FARM CREDIT ADMINISTRATION BOARD, FARM CREDIT ADMINISTRATION

Mr. Chairman, I appreciate this opportunity to appear before the Senate Committee on Agriculture as a nominee to the Farm Credit Administration Board. I am honored to have an opportunity to play a leadership role in the FCA as it regulates and works with the Farm Credit System in solving the System's current financial problems.

In addition to the System's significance as a nationwide network of credit cooperatives lending to agriculture and owned by its borrowers, the System has been established with the unique role as a financial intermediator, efficiently channeling capital from the Nation's capital markets to rural America. I recognize the fundamental strength that cooperative organizations and their leadership have provided to the agricultural economy. Indeed, I have been a member of agricultural supply and marketing cooperatives throughout my adult life. I assure you that as a member of the FCA Board, my recognition of the role that cooperatives play in American agriculture will continue.

I look forward to working with this committee, Congress and the Administration in overseeing and regulating the System through these challenging times, and assuring that the safety and soundness of its institutions are maintained for the benefit of America's farmers who own and borrow from the System, and of those who invest in its bonds. I take seriously the intent of the 1985 amendments, recognizing the responsibility of FCA to assure that System institutions conduct themselves in a safe and sound manner.

The challenge that lies ahead is both with the ability of the System's leadership to make solid, prudent business decisions and of its regulator to assure the continued safety and soundness of these institutions. The 1985 amendments to the Farm Credit Act provide FCA the appropriate tools through strengthened and expanded examination authority to all parts of the System,

including local associations, and through requirements that these institutions accurately report their financial condition to stockholders and investors on a timely basis. These provisions are fundamental to retaining confidence of both borrowers and investors in the System.

FCA and the Farm Credit System can further assure a continued viable System by promptly and fully implementing provisions of the 1985 amendments. Accordingly, the Farm Credit System Capital Corporation must play a key role of serving as the vehicle for financial assistance to troubled institutions and in bringing the System to collectively deal with its troubled assets. In doing so, the Capital Corporation must place appropriate attention on the interests of borrowers and the long-term importance of borrower confidence in the System.

The Farm Credit System currently is facing a serious financial challenge. The Farm Credit Amendments of 1985 are very important to the System in addressing that challenge. I pledge my commitment to work for the prompt, full, and effective implementation of that legislation's provisions.

These are truly challenging times for many farmers, rural businessmen, and those who service their credit needs. I share your concern and recognition of the need for our agricultural economy to return to a strong, dynamic, and growing industry. The cooperative Farm Credit System can make positive contributions to the recovery. I look forward to working with this committee to help achieve such a goal.

United States of America,
Office of Government Ethics,
Office of Personnel Management,
Washington, D.C., May 7, 1986.

Honorable Jesse A. Helms,
Chairman, Committee on Agriculture,
Nutrition, and Forestry
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

In accordance with the Ethics in Government Act of 1978, I enclose a copy of financial disclosure report filed by Marvin R. Duncan,* who has been nominated by President Reagan for the position of Board Member, Farm Credit Administration.

We have reviewed the report and have also obtained advice from the Farm Credit Administration concerning any possible conflict in light of the Administration's functions and the nominee's proposed duties. Based thereon, we believe Mr. Duncan is in compliance with applicable laws and regulations governing conflicts of interest.

Sincerely,

David H. Martin, Director.

Enclosure.

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*Retained in Committee files.

Farm Credit Administration,
McLean, Virginia, May 10, 1986.

Honorable Jesse A. Helms,
Chairman, Committee on Agriculture, Nutrition,
and Forestry, United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

On March 12, 1986, I submitted to the Office of Government Ethics a copy of my SF 278, Financial Disclosure Report, required in connection with my nomination to serve as a Member of the Board of Directors of the Farm Credit Administration. That report contained all required financial information for calendar year 1985 and for the current calendar year through March 12, 1986.

The Ethics in Government Act of 1978, as amended, also required that I update certain parts of the information reported on the SF 278, i.e., that required by section 202(a)(1)(A) of the Act, respecting income (other than dividends, interest, rents, and capital gains) and honoraria, to a date which occurs five days before the date of the hearing held by your Committee to consider my nomination. The hearing to be held on my nomination is presently scheduled for Thursday, May 15, 1986. The purpose of this letter is to report that, as of May 10, 1986, I have received no income or honoraria in addition to those categories and amounts of income dated and filed on March 12, 1986, other than my salary from the Farm Credit Administration and one monthly payment of approximately $262.00 paid under Federal Reserve System retirement.

I trust that this letter satisfies the additional applicable reporting requirements contained in the Ethics in Government Act.

Sincerely,

Marvin Duncan, Senior Director.

BIOGRAPHICAL SKETCH OF MARVIN R. DUNCAN, SENIOR DEPUTY GOVERNOR, OFFICE OF THE GOVERNOR, FARM CREDIT ADMINISTRATION

Marvin R. Duncan is senior deputy governor for the Farm Credit Administration where he is responsible for directing strategic planning for the agency. He also assists in representing the Farm Credit Administration to the administration, Congress, other financial institutions, the Farm Credit System, and the public.

Before joining FCA, Dr. Duncan was a vice president and economist with the Federal Reserve Bank of Kansas City, where he headed the regional economics group within the Economic Research Department and was responsible for directing research in agriculture, energy and regional economics. He joined the bank in 1975 as an agricultural economist and was appointed to the official staff in 1979. Before going the Federal Reserve, Dr. Duncan spent 15 years in farm management and agribusiness and served on the faculties of North Dakota State University and Iowa State University.

Dr. Duncan writes and speaks widely on economic topics and is active in banking education. He is past chairman of the National

Planning Association's Food and Agriculture Committee and is a member of the U.S. Department of Agriculture's National Agricultural Cost of Production Standards Review Board. He holds undergraduate and graduate degrees from North Dakota State University and earned a Ph.D. degree in agricultural economics from Iowa State University.

The Farm Credit Administration is an independent Federal agency responsible for the regulation, examination, and supervision of the Farm Credit System, a nationwide network of agricultural lending institutions and their service organization.